The Proposed

NEW BRUNSWICK
PERSONAL PROPERTY SECURITY ACT

With Introductory Notes and Commentary

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INTRODUCTORY NOTES

WHY SECURED FINANCING?

Credit is tightly woven into the economic fabric of society. In the world of commerce, expansion and production is typically fueled by loan capital. In the consumer world, it is commonplace and socially acceptable to acquire assets on deferred payment terms.

Credit may take the form of loan credit or sale credit. Loan credit involves the direct advance of money from lender to borrower. Sale credit involves the supply of goods or services on deferred payment terms.

Whichever form it takes, the extension of credit is an inherently risky business. Even though the debtor's financial prospects may be healthy when credit is extended, the risk of default increases if more creditors later enter the picture. And the unknowable future can bring a loss of job, a downturn in business, or a drastic change in the overall economic climate.

Securing the debt by taking an interest in the debtor's assets is the best protection that the law offers a creditor against the risk of default. Security gives the creditor *real* enforcement rights exercisable out of court, enabling it to seize and sell the collateral on default without judicial intervention and then apply the proceeds against the debt. Unsecured creditors, by contrast, must first reduce their claim to judgment and then invoke execution before they can exact repayment out of the debtor's assets. More importantly, secured creditors have a prior claim to the collateral ahead of the debtor's general creditors or trustee in bankruptcy. Finally, a security interest gives the creditor greater leverage and bargaining power in its day to day relations with the debtor, encouraging timely payment.

THE EVOLUTION OF PERSONAL PROPERTY SECURITY LAW

While the real property mortgage has been around in one form or another for many centuries, wide-spread financing on the security of personal property is essentially a nineteenth century phenomenon. Before then, security in intangibles was virtually unheard of while the pledge or pawn was the only really effective means to create a security interest in chattels.

In hindsight, this state of affairs is not surprising. In an agrarian economy where land represented the primary asset and wealth was relatively static, there was little need or demand for personal assets secured financing.

The Industrial Revolution changed everything. The process of industrialization itself created an enormous ongoing demand for credit capital which because of the inherent risks involved could only be met though secured credit. Industrialization also brought about a dramatic shift in the balance of a debtor's valuable assets from land to personal property. The obvious answer to the urgent demand for secured credit was to make the new assets generated by the industrialization process itself available as collateral. Industrial equipment, stock-in-trade and a business' accounts receivable generated by their sale all represented attractive sources of collateral to fuel an ever-expanding dynamic economy.

THE EXISTING NEW BRUNSWICK LAW OF PERSONAL PROPERTY SECURITY

Today, personal property represents as ubiquitous a source of debt collateral as land in both the commercial and consumer worlds. But despite its economic significance, personal property financing in New Brunswick is hampered by a badly fragmented and staggeringly complex legal framework which fails to accommodate many modern commercial practices. The existing personal property security law is not one law but many laws. Over the years, a wide variety of discrete security devices have come into commercial use to facilitate changing financing needs (the best known being the pledge, the conditional sale and the common law and equitable mortgage and charge). Although all these devices are intended to perform a common security function, their ad hoc and separate recognition has frequently led to artificial differences in the rules governing the creation, enforcement and priority status of each. Moreover, these rules are often based on historical concepts, the contemporary commercial justification for which is far from apparent on their face.

Legislative intervention has exacerbated not relieved the fragmentation and complexity. Over the years, the New Brunswick legislature has established no less than four separate statutory regimes to regulate the registration of security interests in personal property: the *Bills of Sale Act*, the *Conditional Sales Act*, the *Assignment of Book Debts Act* and the *Corporation Securities Registration Act*. Which regime regulates a particular transaction depends on a complex mix of factors: the nature of the collateral, the type of security device, the form of the security documentation and the corporate or non-corporate status of the debtor. The logistics of registration and searching are rendered even more complicated by the fact that, with the exception of the *Corporation Securities Registration Act* record, these registries are operated on a county basis. The limited degree of legislative reform that has taken place on other issues - such as default procedures or protection for purchasers of the collateral - has been accomplished in a similarly ad hoc and fragmented fashion.

The existing multiplicity of security devices and filing regimes makes it difficult to consolidate security interests taken against different types of property in a single security agreement subject to a single registration act. The parties' freedom to draft a tailor-made security agreement is further hampered by prolix documentary filing requirements. The highly technical nature of these requirements, coupled with the absence of an integrated central registry system makes secured lending in New Brunswick a very risky business for financing institutions and not inconsequentially for their legal counsel.

A related source of difficulty is the failure of the existing law to accommodate many contemporary commercial practices. For example, the *Bills of Sale Act* and the *Corporation Securities Registration Act* both require that the amount or the extent of the secured indebtedness be set out in the registered security documentation. Yet most commercial loans today contemplate either a revolving line of credit or a series of future advances, the total amount or potential extent of which cannot always be known at the time the security agreement is executed.

The existing law poses particular problems for inventory financing. The *Conditional Sales Act*, for instance, does not permit the filing of a single conditional sales contract to cover an ongoing supply of inventory even though the "wholesale" conditional sales contract has become a commonplace means of financing the acquisition of inventory by retailers and dealers. Rather, a separate conditional sales contract must be executed and registered with each fresh delivery of inventory. It is also difficult under the existing law for an inventory financier to acquire an effective security interest in the proceeds of sale of the inventory, even though such an interest is critical to the intended operation of the security arrangement.

Finally, the existing law contains an unacceptable level of uncertainty on a wide array of important issues. The scope of the various registration statutes, for instance, is still unclear, causing some to adopt the precautionary practice of filing their security agreements under two or more statutes. A problem at the other extreme is the absence of any registration mechanism whatsoever for novel security devices and many intangible or hybrid forms of collateral. This in turn has led to uncertainty on whether it is possible to take an effective security interest in many species of collateral.

Most importantly, perhaps, the numerous unresolved issues in the critical realm of priorities and led either to litigation or to settlements premised on confusion and compromise rather than on certainty and agreement. Many of these unresolved issues stem from the a lack of integration between the registration statutes and the common law and equitable principles which preceded their introduction.

ARTICLE 9 OF THE UNIFORM COMMERCIAL CODE

The deficiencies in the existing New Brunswick law are not unique to this province. They are the heritage of all common law legal systems and derive from the *ad hoc* way in which chattel security law expanded and evolved everywhere over the last century.

Article 9 of the Uniform Commercial Code in the United States represented the first attempt at a statutory integration and consolidation of the law of personal property security. In retrospect, it is hardly surprising that the United States was the first of the common law derivative legal systems to rationalize its personal property security law. By the time work on the Code commenced, American personal property security law was in a highly complex and overly formalized state. The old rules restricting the alienability of personal property for security purposes had all but broken down. With some fifty jurisdictions, the commercial pressures for uniformity were immense. Moreover, judicial resistance to wide-open lending had been even more strict in the United States than in either England or Canada, exemplified most dramatically by the failure of American law to recognize the floating charge. That failure made wide open lending on the debtor's full business undertaking a far more complex and formalistic process than was the case elsewhere.

The idea of integrating commercial law into a single comprehensive statutory code was first conceived in 1940 by William Schnader, then President of the National Conference of Commissioners on Uniform State Law. His proposal was endorsed by the Commissioners that same year and shortly afterwards attracted the co-sponsorship of the American Law Institute (of Restatement fame). In 1944, the Uniform Commercial Code Project was formally launched under the inspired direction of the great "realist" scholar and commercial lawyer, Professor Karl LLewellyn, as Chief Reporter with his spouse, Soia Mentschikoff as Associate Chief Reporter. The first version of the Code, published as the "1952 Official Text", was completed in record time in 1951. The result still stands as the most widely accepted and most influential work that either co-sponsor has ever promulgated. Beginning with Pennsylvania in 1953, one of the three Official Texts (1962, 1972 and 1978) of the Code had been adopted by all fifty states, the District of Columbia and the Virgin Islands.

Of all the Code Articles, Article 9 on secured transactions easily qualifies as the most innovative and successful. The last hold-out, Louisiana, finally enacted Article 9 last year. That it was at long last able to overcome its civilian heritage is compelling testimony to the universality of the Code's appeal.

One manifestation of genius in legal scholarship lies in knowing when the exceptions to the old order have accumulated sufficient weight and force to create a new order. Two men who possessed that genius were Professor LLewellyn and University of Chicago Law Professor Allison Dunham, the Reporter for Article 9. In the course of drafting Article 9, they arrived at the conclusion that behind the existing badly-fragmented "system" of discrete security devises lay a unifying synthesis. The "system" of discrete security devices had done its work and the time had come to replace it with the simple concept of a single generic security interest in personal property. Working independently of the Code Project, Professor Grant Gilmore of Harvard arrived at the same conclusion and when his views were published in the Yale Law Journal in 1948, he was invited to join Professor Dunham as Reporter for Article 9. Together the two succeeded in transforming the law of personal property security from many laws to a single law with distinctions between secured transactions drawn along functional rather than formalistic grounds.

ARTICLE 9 IS EXPORTED TO CANADA

Not surprisingly, article 9 has proved to be a highly exportable legal product. In Canada, Article 9-inspired reform originated in Ontario in 1959 with the creation of the "Catzman Committee" by the Ontario Commercial Law Section of the Canadian Bar Association. This Committee, chaired by F.W. Catzman Q.C., was asked by the then Attorney-General of Ontario to undertake a review of that province's personal property security law. It is not surprising that the Catzman Committee quickly settled on Article 9 as the appropriate reform model. Historically, Canadian chattel security law has tended to borrow as much from the United States, particularly when it comes to uniform legislative models, as it has from England. Moreover, as another common law derivative system, Ontario's personal property security law was in a similar if not as profound a state of unnecessary fragmentation and complexity to pre-UCC American state law.

By 1963 the Committee's efforts had culminated in a draft bill, enacted in 1967 as the *Personal Property Security Act*. Development of a computerized registry system to complement the new and integrated legal regime took time, however, and except for the provisions dealing with the establishment of the PPSA registry, the Act - revised in 1973 - was not proclaimed in force until April Fool's Day 1976.

Personal Property Security Acts derived from Article 9 are now in force in the majority of Canadian provinces, beginning with Ontario in 1976[1] and spreading west to Manitoba[2] in 1978, Saskatchewan[3] in 1981, the Yukon Territory[4] in 1982, and Alberta[5] and British Columbia[6] in 1990. The Canadian adaptation of Article 9 has in turn spawned proposals for similar legislative reform in England[7], Australia and New Zealand[8].

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[1] Ontario PPSA, SO 1967 c. 73; see now Ontario PPSA 1989 SO 1989 c. 16 (proclaimed in force Oct 10, 1989)

[2] Manitoba PPSA, SM 1973 c. 5, CCSM c. P-35

[3] Saskatchewan PPSA, RSS 1978 c. P-6.1. For the background, see Saskatchewan Law Reform Commission, *Tentative Proposals for a Saskatchewan Personal Property Security Act* (February 1976) and *Proposals for a Saskatchean Personal Property Security Act* (July 1977); see (1977-78) 42 Sask L Rev 274

[4] Yukon PPSA, RSYT, c. P-32

[5] Alberta PPSA, SA 1988, c. P-4.05, passed July 1988, proclaimed in force October 1 1990.

[6] British Columbia PPSA, SBC 1989, c. 36, passed June 15, 1989, in force on Oct 1 1990. British Columbia has had a long-standing committment to PPSA reform. See British Columbia Law Reform Commission, *Report on Debtor-Creditor Relations, Part V* (1975)

[7] Professor Aubrey L Diamond, *Reform of the Law relating to Security Interests in Personal Property*, Report to the Department of Trade and Industry recommending English and Scottish adoption of an Article 9 style statute. For a summary discussion of the report, see Mark Lawson, *The Reform of the Law relating to Personal Property Security* (1989) J of Business Law 287

THE PROPOSED NEW BRUNSWICK PERSONAL PROPERTY SECURITY ACT

That the winds of PPSA reform would eventually blow east was inevitable. In May 1987, the Law Society of New Brunswick reported to the Hon. James Lockyer, Minister of Justice, that the time had come for a *Personal Property Security Act* in New Brunswick. With more and more PPSA regimes fully operational in the rest of the country, it was felt that there could be little advantage in New Brunswick continuing to await the outcome of experience elsewhere. The Minister agreed wholeheartedly and the Law Reform Branch of Justice commissioned a PPSA proposal for the province.

In Canada as in the United States, the room for local options is limited in a field like personal property financing which cuts across interprovincial and increasingly international boundaries. Accordingly, in choosing a PPSA Model for New Brunswick, the goal of interprovincial and interjurisdictional harmonization had to be a primary value. But while the Uniform Commercial Code Project was the brainchild of two national institutions, harmonization in Canada was hampered at the start because of the origins of PPSA legislation as the reform effort of a single province.

The first concerted effort at a more national appraoch began as early as 1964 when the CBA established a Committee to review the desirability of a draft Uniform Personal Property Security Act for possible adoption by all provinces. The Committee's work reached fruition in a Model Uniform Personal Property Security Act (MUPPSA) adopted by the CBA at its annual meeting in 1970. Though based on the Ontario PPSA, the MUPPSA remedied several flaws in that first effort including one fundamental one. Against the advice of the Catzman Committee, the Ontario government had decided to retain a separate registration system for corporate security interests, a decision clearly antithetical to the kingpin of Article 9 - a single generic security interest. MUPPSA prescribed a truly integrated personal property security law and registry system and it was this model which formed the basis for Manitoba's PPSA, enacted in 1973 and proclaimed in force in September, 1978.

PPSA reform soon attracted the attention of another prominent organization concerned with interprovincial harmonization of legislation. In 1971, the Uniform Law Conference of Canada (then still known as the Conference of Commissioners for Uniformity of Legislation in Canada) adopted a Uniform PPSA modelled on the Ontario PPSA and MUPPSA. In 1982 it joined forces with the Canadian Bar Association to jointly sponsor a revised Uniform PPSA. The new model incorporated modifications which had been introduced with the "second generation" Saskatchewan PPSA (on which the Yukon PPSA is modelled) which took account in turn of major intervening amendments to Article 9 in the United States.

But when Ontario came to revise its PPSA, it chose not to replace it with the Uniform PPSA. By the time the 1982 Uniform Act was ready, substantial work had already been undertaken on the Ontario revision by the original Catzman Committee who had been charged with the role of monitoring and advising the Ontario Committee on revision. Moreover, the Ontario government proved to be unwilling to accept the recommendations of the Catzman Committee on several key issues including the extension of the act to commercial consignments and long term chattel leases as a result of lobbying efforts. Had these recommendations been accepted, the new Ontario PPSA, which was finally enacted in 1989, would have come considerably closer to the Uniform model.

(continued)

[8] See New Zealand Law Commission, *Reform of Personal Property Security Law*, published as Preliminary Report No. 6 (May 1988) and being a report to the Commission by Professor John H. Farrar and Mar A. O'Regan; *A Personal Property Securities Act for New Zealand*, published as Report No. 8. For a summary analysis of the New Zealand proposal, see J.H. Farrar, *New Zealand considers a Personal Property Security Act* (1990) 16 CBLJ

Efforts at national harmony having apparently broken down, representatives from Alberta, British Columbia, Saskatchewan and the Yukon and Northwest Territories, joined forces in 1986 to form the Western Canada PPSA Committee. The aim of the new body was to harmonize uniform PPSA legislation in Western Canada. The moving force behind the new body was Prof Ronald Cuming of the Law School at the University of Saskatchewan, a who had been a member of the joint comittee on a uniform PPSA and chief architect of the Saskatchewan PPSA. A Model Western Canada PPSA was adopted in 1987 and amended in 1988 and 1989. The Western Model is a refined or third generation version of the Saskatchewan and the 1982 Uniform PPSA.

Contemporary PPSA legislation thus presented New Brunswick with two models: the new Ontario PPSA and the Western Model PPSA. With common roots in Article 9, both versions naturally share the same basic structure and philosophy. But there are significant differences not just in drafting style but in substantive result and in overall legislative policy.

The proposed New Brunswick PPSA adopts the Western rather than the Ontario model. The Western approach offers considerably more detailed direction on many issues and, where the two models differ in point of substance or policy, the Western version is regarded as steering the preferable course on most issues.

Most importantly, adoption of the Western Model best promotes the important goal of interjurisdictional harmonization of PPSA law. It has been adopted by both the British Columbia and Alberta legislatures and is expected to be the model for the Northwest Territories PPSA when one is enacted. The Saskatchewan Law Reform Commission has recently recommended its immediate adoption in place of the current Saskatchewan PPSA and it is expected to be only a matter of time before Manitoba and the Yukon follow suit.

The prospects of achieving interjurisdictional legislative harmony through the Western Model have recently received an additional boost. The initial goal of the Western Canada Personal Property Security Committee was to secure harmony in PPSA legislation in the western provinces and northern territories. But in 1989, representatives from both Ontario and New Brunswick began to attend the Committee's annual meetings. Their participation, combined with New Brunswick's active consideration of a PPSA based on the Western Model, led the Committee to decide in 1990 to "nationalize" its harmonization goals. That decision reached fruition at the June 1991 meeting which also saw the attendance for the first time of representatives from the federal government. A new constitution was proclaimed recreating the Western Committee as the Canadian Conference on Personal Property Security Law.

The principal mandate of the new Conference is to "encourage and facilitate harmonization and compatibility of provincial, territorial and federal personal property security law". To provide the structural support for that mandate, the Conference has given birth to a Registry Committee and a Legislative Review Committee. The task of the Registry Committee is to facilitate the exchange of expertise and information among Personal Property Registrars and to achieve greater harmony in Registry practices and operational infrastructures. The task of the Legislative Review Committee is to review and assess proposals for changes to the Model Act. This will provide a significant hedge against idiosyncratic, overly hasty or unnecessary local variations while also ensuring that the Model Act remains responsive to changes in commercial practice.

FORMAT OF PROPOSAL

(continued)

What follows here is a summary of the highlights of the proposed new regime. The text of the proposed Act is then set out accompanied by a section by section commentary.

The commentary is intended to fulfill a number of goals.

Firstly, it will provide the New Brunswick business and legal communities with sufficiently detailed information on the new regime to allow for informed discussion and feedback to government.

Secondly, it will perform an educational function, enabling those who will have to work within the new regime to adequately familiarize themselves with its basic scope, purpose and philosophy well in advance of implementation. The experience in PPSA jurisdictions to date indicates that the greater the availability of advance information on the content and goals of PPSA legislation, the less pronounced the pain of transition[9].

Thirdly, the commentary seeks to compare, to the extent that time has thus far allowed, the existing law on the issue under discussion with the PPSA resolution. The aim here is to emphasize the continuity between the existing New Brunswick law of personal property security and the PPSA model. For while PPSA reform is welcome reform, it changes almost nothing in the way of fundamental policy. Its principal public benefit lies in consolidating, rationalizing and refining existing law and commercial practice, not in changing it. Larger questions such as the need for special consumer protection measures or the continued desirability of a *laissez-faire* approach to secured financing are left for another day. The PPSA, in other words, is largely old wine in a shiny new bottle.

Finally, the commentary also seeks to compare, again to the extent that time has thusfar allowed, the 1989 Ontario PPSA with the Western Model PPSA and to articulate the reasons for the differences in approach.

SCOPE OF THE PROPOSED PPSA

The genius of Article 9 and PPSA legislation lies in replacing the old 'system' of discrete security devices with the simple concept of a generic "security interest". It is this evolutionary step which, more than anything else, makes it possible to integrate all aspects of personal property financing in one legislative treatment.

The proposed PPSA will apply to all agreements which create a security interest in personal property or fixtures. Security interest is defined in functional terms to mean any interest taken in collateral to secure a debt or other obligation, regardless of form or title of the transaction. As such, the Act will apply to the full array of conventional security devices as well as to other more novel transactional forms where they employed to perform a security function.

The registration and priority aspects of the proposed PPSA will also extend to certain non-security dealings in personal property: notably, long-term chattel leases, commercial consignments and absolute transfers of accounts or chattel paper. They have been included for one or both of two policy reasons: to publicize the true state of title to third parties and to reduce debate and litigation on the character of the transaction.

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[9] At the time work on the commentary commenced, the reference material available on the PPSA in general and the Western Model PPSA in particular was quite limited. But 1990 saw the publication by Carswell of an excellent Handbook by Ronald Cuming and Roderick Wood on both the Alberta and British Columbia PPSA's which are of course derived from the Western Model. The reader is referred to these as well as to the 1991 edition of Ziegel, Cuming and Geva, *Commercial and Consumer Transactions: Cases Text and Materials*, which gives a helpful comparison between the Western Model and the 1989 Ontario PPSA.

THE PERSONAL PROPERTY REGISTRY

The proposed PPSA will replace the four existing registry systems with a single Personal Property Registry. Although registry clientele will still be able to conduct registrations and searches locally, the new system will have a computerized province-wide registration data base.

Like the current registry systems, the Personal Property Registry is intended to ensure public disclosure of security interests taken in assets that have been left in the debtor's possession or control. However, registration is presently required only if the collateral takes the form of chattels or book debts. In contrast, the proposed system will apply to non-possessory security interests in all categories of personal property.

The PPSA itself will apply only to consensual security interests. However, the Personal Property Registry will be designated as the appropriate registration venue for a wide variety of non-consensual encumbrances against personal property, giving credit searchers the convenience of 'one-stop shopping'.

The proposed new registry will adopt the concept of notice filing. Rather than having to register the complete security documentation, secured parties will file only a simple notice document called a "financing statement". The financing statement will set out only the basic information necessary to alert a searcher that a security interest may have been taken in certain collateral. Those who have a legitimate interest in knowing more details will be entitled to demand particulars from the secured party of record.

With notice-filing, there is no reason why a single registration cannot cover multiple or successive security agreements provided the registered data continues to accurately reflect the current financing arrangement. The proposed PPSA will permit a single registration to relate to more than one security agreement, a feature that will prove especially advantageous to inventory financiers.

Notice-filing also eliminates any practical obstacle to pre-agreement registration and the PPSA will permit a financing statement to be registered before the security agreement is entered into. Advance registration will enable the immediate release of loan funds and eliminate the need to provide "grace periods" for registration. It will also allow a secured party to ensure its priority ranking while still at the negotiation stage since priority under the PPSA generally relates back to the date of registration. Stringent discharge requirements will protect debtors from the risk of "false registrations" should the security agreement fail to materialize.

Under the existing registration statutes, the filing must be renewed every three years. The single exception is the *Corporation Securities Registration Act* under which a registration remains effective in perpetuity or until positively discharged. The PPSA will introduce the flexibility of variable registration life, sharply reducing the risk of lapse. The Regulations to the Act will permit a secured party to select a registration life of from one to twenty-five years or perpetuity. Registration fees will be prescribed according to a sliding tariff of fees scaled to the period of registration life selected.

PRIORITIES

In providing a comprehensive priority code, the PPSA will bring much-needed certainty to the resolution of priority disputes among secured parties claiming a security interest in the same collateral.

As a general rule, priority under the PPSA will be determined according to the order of registration of the competing interests, regardless of when they may actually have attached.

However, registration is not required where the secured party takes possession of the collateral since possession functions just as effectively as registration to publicize the security interest. In the event of a contest between a secured party who has "perfected" its security interest by registration and one who has "perfected" by taking possession, priority will be determined according to the order of the perfecting events.

It may happen, albeit rarely, that none of the conflicting security interests will have been perfected either by registration or taking possession. In that event, the order in which the security interests attached will determine priority.

In addition to these general priority rules, the PPSA will also provide more specialized priority rules in circumstances where commercial practice, elementary fairness or the nature of the particular collateral require a more highly tuned resolution. Notable examples include the super-priority rule for purchase money financiers and the detailed guidance provided on priority disputes involving collateral which takes the form of fixtures, growing crops, accessions, or commingled goods.

Priority disputes may arise not only among secured parties but also between a secured party and a subsequent buyer or lessee of the collateral as well as between a secured party and the debtor's execution creditors or trustee in bankruptcy. The PPSA will also provide comprehensive guidance on resolving both classes of disputes.

DEFAULT RIGHTS AND REMEDIES

For the most part, the proposed PPSA rules on default enforcement reflect existing commercial practice. On default, the Act will give the secured party two basic options. It can seize the collateral, dispose of it by sale, apply the proceeds against the debt and expenses and claim any remaining deficiency from the debtor. Alternatively, the secured party may elect to simply take the collateral in full satisfaction for the debt provided those with an interest in the collateral have no legitimate grounds for objection.

The proposed PPSA will also preserve the debtor's time honored rights to redeem the collateral and to claim any surplus proceeds where the collateral is disposed of by sale. But a new debtor remedy will also become available. A defaulting debtor will have a limited right to reinstate the security agreement on payment of enforcement expenses and the sum actually in arrears exclusive of the operation of any acceleration clause.

Finally, the proposed PPSA will give express recognition to the wide-spread use of receivers and receiver-managers in commercial debt realizations. Receivers will be made expressly subject to the general enforcement requirements of the Act where appropriate and some aspects of existing receivership will be consolidated and refined.

CONCLUSION

The fact that PPSA reform came about to remedy the very deficiencies which presently plague the New Brunswick law of personal property security is reason enough to welcome its advent in this province. But there are others. The adoption of a PPSA will finally bring New Brunswick law into line with the legal framework governing secured financing in the rest of North America. This will facilitate the involvement of the New Brunswick business community in national and continental financing transactions and allow the New Brunswick legal community to once again participate in and benefit from the jurisprudence and commentary in the rest of Canada.

But it must also be emphasized that personal property security is an inherently complex field. It is true that the PPSA will reduce that complexity by at least placing the rules within two covers. Beyond that, however, the sheer number of relevant players whose interests must all be balanced - the debtor, the secured party, other secured parties, general creditors and their representatives, transferees of the collateral and the general public - render a radically simplified legislative treatment impossible.

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NEW BRUNSWICK
PERSONAL PROPERTY SECURITY ACT

(based on the Western Model PPSA adopted by the Canadian Conference on Personal Property Security Law)

With Commentary

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CONTENTS

PART 1 INTERPRETATION AND APPLICATION

Section 1(1) Definitions
Section 1(2) The Meaning of Knowledge
Section 1(3) Classification of Goods Collateral
Section 1(4) Proceeds Traceable without Fiduciary Relationship
[Section 1(5) Interjurisdictional Harmony]
Section 2 Application to True Security Interests
Section 3 Application to Deemed Security Interests
Section 4 Exclusions from Application of Act
Section 5 Conflict of Laws: Goods and Documentary Collateral in the Possesion of the Secured Party
Section 6 Conflict of Laws: Goods to be removed from the Jurisdiction
Section 7 Conflict of Laws: Mobile Goods, Intangibles, Extracted Minerals and Non-Possessory Security Interests in Documentary Collateral
Section 8 Conflict of Laws: Substance and Procedure

PART 2 VALIDITY OF SECURITY AGREEMENT AND RIGHTS OF PARTIES

Section 9 Freedom of Contract
Section 10 Evidentiary Requirements for Enforceability of Security Agreements against Third Parties
Section 11 Debtor's Right to Copy of Security Agreement
Section 12 When Attachment Occurs
Section 13 Security in After-acquired Property
Section 14 Future Advances
Section 15 Application of Sales Law
Section 16 Acceleration Clauses
Section 17 Collateral in the Secured Party's Possession - Rights and Obligations
Section 18 Obtaining Information about the Security Agreement

PART 3 PERFECTION AND PRIORITIES

Section 19 Attaining Perfection
Section 20 Subordination of Unperfected Security Interests to Execution Creditors, Trustee in Bankruptcy and Transferees of the Collateral
Section 21 Damages Recoverable by Lessor or Consignor
Section 22 Grace Period for Perfection of Purchase Money Security Interests
Section 23 Continuity of Perfection
Section 24 Perfection by Possession
Section 25 Perfection by Registration

Section 26 Temporary Perfection despite return of Collateral to Debtor
Section 27 Perfection where Goods Held by Bailee
Section 28 Security Interest in Proceeds
Section 29 Perfection and Priority with respect to Returned, Seized or Repossessed Goods
Section 30 Priority of Buyers and Lessees of Goods
Section 31 Priority of Holders and Purchasers of Money, Instruments, Securities, Documents of Title or Chattel Paper
Section 32 Priority of Repairer's Lien
Section 33 Free Alienability of Debtor's Rights in Collateral
Section 34 Priority of Purchase Money Security Interest
Section 35 Residual (General) Priority Rules
Section 36 Security Interests In Fixtures
Section 37 Security Interests in Growing Crops
Section 38 Security Interests in Accessions
Section 39 Security Interests in Processed or Commingled Goods
Section 40 Voluntary Subordination
Section 41 Assignments of Intangibles and Chattel Paper - Rights of Third Party Account Debtors

PART 4 REGISTRATION

Section 42 Personal Property Registry
Section 43 Registration of Financing Statements
Section 44 Duration, Renewal of and Amendments to Registrations
Section 45 Registrations of Transfers and Subordinations
Section 46 Removal of Information from Registry
Section 47 Registration not Constructive Notice
Section 48 Registry Searches
Section 49 Fixtures and Growing Crops - Registrations in the Land Registry or Land Titles Office
Section 50 Compulsory Discharge or Amendment of Registration
Section 51 Transfer of Debtor's Interest in Collateral or Change of Debtor's Name
Section 52 Recovery of Loss caused by Error in Registry
Section 53 Recovery of Loss where Trust Deeds Involved
Section 54 Payment of Claim for Loss

PART 5 DEFAULT RIGHTS AND REMEDIES

Section 55 Application of Part 5
Section 56 Rights and Remedies on Default
Section 57 Right to Collect on Intangibles, Chattel Paper and Instruments and to Take Control of Proceeds
Section 58 Right to Take Possession of Collateral and Otherwise Enforce Security Agreement
Section 59 Right to Dispose of Collateral after Seizure or Repossession
Section 60 Surplus or Deficiency after Disposal

Section 61	Right to Retain Collateral in Satisfaction of Debt
Section 62	Redemption of Collateral and Reinstatment of Security Agreement
Section 63	Supervisory Powers of Court
Section 64	Receiverships
PART 6	TRANSITIONAL AND MISCELLANEOUS
Section 65	Supplementary Law and Duties of Good Faith and Commercial Reasonableness
Section 66	Action for Damages for Non-compliance
Section 67	Application to Court for Determination of Priorities or Entitlement to Collateral
Section 68	Application to Court for Extension of Time
Section 69	Service of Notice
Section 70	Conflict between PPSA and Other Legislation
Section 71	Transitional - References to Previous Legislation and Terminology
Section 72	Transitional Application of Act
Section 73	Transitional Perfection of Pre-PPSA Security Interests
Section 74	Regulations

PART 1
INTERPRETATION AND APPLICATION

Note on Format of Commentary to Section 1

For the other sections of the Act, the complete text of the relevant section is first set out in bold type followed by the commentary. But the length of section 1 is such that it was thought to be more convenient in this one case to place the commentary after each definition in subsection (1) and then after each subsection of section 1.

SECTION 1(1)

DEFINITIONS

Section 1(1) gives legislative expression to a wide variety of commercial concepts, many of which have never been made the subject of legal definition before but which will be familiar to those familiar with the world of secured financing.

While the list of definitions is lengthy, they organize into relatively few categories. The majority define types of collateral within the PPSA personal property classification scheme. Others define the legal actors, institutions and documents involved in a secured financing transaction.

Statutory definitions have little interest or significance in the abstract and the commentary that follows seeks primarily to cross-reference each definition to the sections to which it relates, leaving a more detailed analysis to be made in the context of specific sections in which the definition is relevant.

1(1) In this Act,

"accessions" means goods that are installed in or affixed to other goods;

The common law doctrine of accession gives the property in goods installed in or affixed to other goods to the party with the interest in the whole. Various tests have been canvassed for determining when goods qualify as accessions so as to thus attract the right of accession[1]. Can the accessory chattels be removed without physical injury to the whole? Have the accessory chattels lost their identity in the installation process? How significant is the accession to the utility of the whole? What was the degree and the purpose of annexation?

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[1] *Industrial Acceptance Corp. v. Firestone Tire & Rubber Co.* (1968) 8 DLR (3d) 770 (Alta CA), reversed on appeal (1971) 17 DLR (3d) 229 (SCC)

It is not surprising that the common law has not been able to settle on a consistent legal definition of accessions. The purpose and effect of the characterization exercise is generally to determine priority in the accession in a contest between the party with the interest in the whole and the party with the interest in the accessions. Who should take priority depends on the relationship of the litigating parties and the character of their claims, not the abstract meaning of "accessions". It is the result-oriented nature of the characterization exercise, in other words, which explains why the concept of accessions can vary so from one case to the next[2].

PPSA section 38 establishes a priority and enforcement regime to regulate rights between a secured party claiming a security interest in accessions and a person claiming an interest in the goods in which the accessions are installed or to which they are affixed. Because the PPSA thus 'puts the cart back behind the horse', so to speak, it will no longer be necessary to manipulate the relative rights of the competing claimants to the accession by manipulating the legal meaning of "accession". Accordingly, the concept of "accessions" can be given its ordinary meaning under the PPSA, simply goods installed in or affixed to other goods, unembarrassed by any additional considerations having to do with severability, integral utility and the like[3].

> **"account" means a monetary obligation not evidenced by chattel paper, an instrument or a security, whether or not it has been earned by performance;**

An "account" is a sub-category of "intangible" within the PPSA collateral classification scheme. It is the PPSA equivalent of the existing statutory concept of "book debt" used in the *Assignment of Book Debts Act*. However, the PPSA definition makes it clear that the concept of "account" is restricted to simple monetary obligations. Monetary obligations that are evidenced by chattel paper, an instrument or a security are classified separately and given their own independent statutory definitions[4].

PPSA sections that deal specifically with collateral in the form of accounts include:

section 3	the PPSA applies to a transfer of an account notwithstanding that the transfer does not secure payment or performance of an obligation
section 4	application of the PPSA is excluded in relation to certain specified types of assignments or transfers of accounts
section 20	an unperfected security interest in an intangible (i.e., includes an account) is subordinated to transferees for value without knowledge of the security interest
section 29	provides rules to govern the validity, perfection and priority of security interests in accounts in cases where the account was generated by the sale of goods which are subsequently returned by the buyer or seized or repossessed by the seller

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[2] See the remarks of Laskin J to this effect in *Industrial Acceptance Corp. v. Firestone Tire & Rubber Co.* (1971) 17 DLR (3d) 229 (SCC)

[3] The definitions of "accession" in the new Ontario PPSA and the Western Model are identical.

[4] The definitions of account in the Western Model PPSA and the new Ontario PPSA are virtually identical.

section 34	addresses the priority of a non-proceeds security interest in accounts over a purchase money security interest in the accounts as proceeds of inventory

> **"advance" means the payment of money, the provision of credit or the giving of value and includes any liability of the debtor to pay interest, credit costs or other charges or costs payable by the debtor in connection with an advance or the enforcement of a security interest securing the advance;**

While the new Ontario PPSA just defines "future advance", the Western Model PPSA defines both "advance" and "future advance". Although the definition of "advance" is derived from the definition of "future advance", a separate definition was incorporated in the Western Model in response to a request for clarification from practitioners in view of the fact that some PPSA provisions refer only to "future advance" while others refer to "advance". See further:

section 35	priority of advances in relation to security interests generally
section 36	priority of advances in relation to security interests in fixtures
section 37	priority of advances in relation to security interests in growing crops

> **"building" means a structure, erection, mine or work built, constructed or opened on or in land;**

This definition relates to the definition of "building materials" below.

> **"building materials" means materials that are incorporated or built into a building and includes goods attached to a building so that their removal**
>
> **(a) would necessarily involve the dislocation or destruction of some other part of the building and cause substantial damage to the building, apart from the loss of value of the building resulting from the removal, or**
>
> **(b) would result in weakening the structure of the building or exposing the building to weather damage or deterioration,**
>
> **but does not include**
>
> **(c) heating, air conditioning or conveyancing devices, or**
>
> **(d) machinery installed in a building or on land for use in carrying on an activity in the building or on the land;**

In addition to goods *strictu senso*, the PPSA also applies to fixtures. However, "fixtures" are defined in the Western Model PPSA so as to expressly exclude "building materials" as defined above[5]. This exclusion maintains the existing common law and *Condi-*

tional Sales Act policy. For a more detailed commentary on the scope and rationale for this exclusion, see further the commentary on section 36 dealing with priority in fixtures.

> **"chattel paper" means one or more writings that evidence both a monetary obligation and a security interest in, or a lease of, specific goods or specific goods and accessions, but does not include a security agreement providing for a security interest in specific goods and after-acquired goods other than accessions;**

Chattel paper is a novel category of personal property invented by the drafters of the UCC and carried over into Canadian PPSA legislation[6]. The term connotes a document that embodies not only an account but also a security interest. Its evolution into a separate species of property was prompted by evolving commercial practice. Chattel paper has acquired a quasi-negotiable character such that delivery of possession of the chattel paper documentation (for the purpose of discounting it) has come to be accepted in commerce as effective to transfer the rights which it represents.

The classic example of "chattel paper" is the conventional retail conditional sales contract under which a vendor supplies specific goods on credit but retains title to secure the customer's obligation to pay the purchase price. This type of transaction clearly satisfies the dual definitional characteristics of chattel paper: it evidences both a monetary obligation (the purchase price) and a security interest (the clause reserving title in the goods as security for payment).

However, conditional sales are offered here by way of illustration only and the notion of chattel paper will encompass any other type of document, for instance a chattel mortgage on specific goods, so long as it satisfies the dual definitional characteristics.

The concept of "specific goods" as used in the definition of "chattel paper" is itself defined below. The definition parallels that used in the *Sale of Goods Act*. The effect of restricting the concept of chattel paper to documentation relating to "specific goods" is to exclude debts that are secured by a lien on unascertained or future goods. Consequently, the special PPSA rules designed to deal with the quasi-negotiable status of chattel paper will not reach this case.

Although chattel paper embodies a security interest, it may in turn be used as collateral by the obligee on the chattel paper. Provisions that expressly address the use of chattel paper as collateral include:

section 5	conflict of law rules governing the validity and perfection of possessory security interests in chattel paper
section 7	conflict of law rules governing the validity and perfection of non-possessory security interests in chattel paper
section 17	scope of secured party's duty of reasonable care in relation to collateral in the form of chattel paper in the secured party's possession
section 20	unperfected security interest in chattel paper subordinated to the interest of a transferee for value without notice

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[5] The new Ontario PPSA leaves the development of the "building materials" exception to the common law.

[6] The definition of "chattel paper" in the Western Model PPSA was derived from the Saskatchewan PPSA and it considerably more refined than the version used in the new

section 24	security interest in chattel paper may be perfected by taking possession
section 26	security interest in chattel paper may be temporarily perfected in some instances notwithstanding that possession is returned to the debtor
section 29	validity, perfection and priority of security interest in chattel paper where chattel paper was generated by the sale of goods which are subsequently returned by the buyer or seized or repossessed by the seller
section 31	priority of purchaser of chattel paper as against security interests in chattel paper
section 41	effect of assignment of chattel paper on rights of third party account debtor under the contract with the assignor that produced the chattel paper
section 57	collection rights of secured party on chattel paper before and after default

"collateral" means personal property that is subject to a security interest;

Collateral is a generic term that encompasses all categories of personal property subject to a security interest. In the PPSA classification scheme, collateral sub-classifies into 7 types, each of which is the subject of a separate definition[7]:

(1) goods
(2) documents of title
(3) chattel paper
(4) instruments
(5) money
(6) securities
(7) intangibles

"Goods" in turn are sub-divided, according to their use, into the three independently-defined categories of "consumer goods", "equipment" and "inventory". Other specific categories of goods collateral are also separately defined: see "accessions" and "fixtures". "Intangible" encompasses "account" which is also separately defined.

Many of the provisions of the PPSA apply generally to "collateral" regardless of type. Others regulate specific categories and sub-categories, for a list of which, see the commentary under the definitions of the various categories and sub-categories.

"commercial consignment" means a consignment under which goods are delivered for sale, lease, or other disposition to a consignee, who, in the ordinary course of the consignee's business deals in goods of that description, by a consignor who,

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(continued)
Ontario PPSA.

[7] The definitions of "collateral" in the Western Model PPSA and the new Ontario PPSA are virtually identical.

(a) in the ordinary course of the consignor's business deals in goods of that description, and

(b) reserves an interest in the goods after they have been delivered,

but does not include an agreement under which goods are delivered

(c) to an auctioneer for sale, or

(d) to a consignee for sale, lease or other disposition if the consignee is generally known to the creditors of the consignee to be selling or leasing goods of others;

For a discussion of the meaning and relevance of this definition, see the commentary on section 3 which brings commercial consignments within the scope of application of the perfection, priority and conflicts provisions of the PPSA, notwithstanding that they do not secure payment or performance of an obligation[8].

"consumer goods" means goods that are used or acquired for use primarily for personal, family or household purposes;

Occasionally, the PPSA gives a higher level of protection to consumer debtors and those who deal with consumer collateral in recognition of their relative lack of sophistication or bargaining power or in the interests of commercial convenience where 'small ticket' transactions are involved. It is for the purposes of such provisions that "consumer goods" are separately defined as one of the three sub-categories of "goods" in the PPSA collateral classification scheme.

PPSA provisions which specifically address "consumer goods" collateral include the following:

section 1(2)	goods are "consumer goods" if they are "consumer goods" at the time the security interest in them attaches
section 10	inadequacy of description of collateral as "consumer goods" without further reference to kind
section 13	prohibition against attachment of security interest in after-acquired property that is consumer goods
section 30	priority of buyer or lessee for value without notice of consumer goods that are acquired as consumer goods if purchase price or market value is less than $1,000
section 50	secured party's obligation to discharge a registration relating exclusively to consumer goods within one month after debtor's obligations performed
section 66	secured party's failure to perform certain obligations where collateral is consumer goods gives rise to deemed damages in a prescribed amount

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[8] Since the Ontario PPSA applies only to consignments which are intended to perform a

section 66	onus of proof regarding effect of secured party's failure to comply with certain obligations on right to a deficiency where the collateral is consumer goods

"Court" means the Court of Queen's Bench of New Brunswick

The Court of Queen's Bench of New Brunswick is given jurisdiction over a wide array of issues under various provisions of the PPSA, including the following:

section 11	application by debtor for order for the delivery of a copy of security agreement
section 18	application for an order requiring the secured party to comply with a demand for information and other orders as necessary to ensure compliance
section 36	application for orders relating to reimbursement for damage and postponement of removal where fixtures to be removed from land
section 38	application for orders relating to reimbursement for damage and postponement of removal where accessions to be removed from other goods
section 50	application for orders relating to the discharge, amendment or maintenance of registrations
section 53	application for order relating to the payment of damages for loss caused by registry error where trust indentures involved
section 63	general supervisory power of court to make orders as necessary to ensure compliance or relieve a person from compliance with the requirements of Part 5 relating to default remedies and sections 17, 36, 37 or 38 and as necessary to protect interests in collateral.
section 64	appointment and supervisory powers of court over receiverships
section 67	application to determine questions of priority or entitlement to collateral
section 68	application for extension of time

"creditor" includes an assignee for the benefit of creditors, an executor, an administrator or a committee of a creditor;

"Creditor" bears its ordinary meaning under the PPSA. The statutory definition is intended merely to make it clear that the term encompasses a representative of a creditor such

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(continued)
security function, it does contain any equivalent definition.

as "an assignee for the benefit of creditors, an executor, an administrator or a committee of a creditor". Note that the term is *not* meant to cover a representative of the *body* of creditors, such as a trustee in bankruptcy under the *Bankruptcy Act* and a liquidator under the *Winding-up Act*. This is because their rights are stated independently in the PPSA: see, for instance, section 20(1) which renders an unperfected security interest ineffective against a trustee in bankruptcy.

"crops" means crops, whether matured or otherwise, and whether naturally grown or planted, attached to land by roots or forming part of trees or plants attached to land, and includes only trees that

(a) are being grown as nursery stock,

(b) are being grown for uses other than for the production of lumber and wood products, or

(c) are intended to be replanted in another location for the purpose of reforestation;

While the PPSA treats growing crops as goods, it provides a priority regime to govern when a security interest taken in crops comes into competition with an interest in the land acquired before the crops are harvested.

The definition of "crops" is relevant to the following sections:

section 12	debtor has no rights in crops so as to permit a security interest to attach until they become growing crops nor in trees, other than crops, until they are severed
section 13	security interest does not attach to after-acquired property that is a crop that becomes a growing crop more than one year after the security agreement is entered into except where interest is given in conjunction with an interest in the realty.
section 34	priority of perfected "purchase money security interest" in crops over other PPSA security interests in the crops
section 37	rights and priorities between a security interest in a crop and interests taken in the land before the crops are severed.
section 49	registration of security interest in crops in land registry office

"debtor" means

(a) a person who owes payment or performance of an obligation secured, whether or not that person owns or has rights in the collateral,

(b) a person who receives goods from another person under a commercial consignment,

(c) a lessee under a lease for a term of more than one year,

(d) a transferor of an account or chattel paper,

(e) in sections 17, 24, 26, 58, 59(13), 61(7), 64(3) and 65, the transferee of a debtor's interest

in the collateral, and

(f) if the person referred to in (a) and the owner of the collateral are not the same person means

(i) where the term is used in a provision dealing with the collateral, the person who has an interest in the collateral,

(ii) where the term is used in a provision dealing with the obligation, the obligor,

(iii) where the context permits, both the owner and the obligor;

Part (a) of the PPSA definition gives "debtor" its ordinary meaning. Part (a) makes it clear that a person need not have an interest in the collateral in order to qualify as a "debtor", as for instance where one person guarantees repayment of a secured loan given by another and covering that other's property. Part (f) of the definition offers further guidance in determining who is the "debtor" for the purposes of specific provisions of the Act in cases where the person who owes performance of the obligation is not the same as the person whose property was used as the collateral.

The lessees, commercial consignees and transferors of accounts and chattel paper who are referred to in parts (b), (c) and (d) of the definition may not be "debtors" in any ordinary sense. However, it is necessary to deem them to be "debtors" because PPSA section 3 brings certain non-security transactions within the scope of application of the Act.

Finally, part (e) of the definition lists the sections of the Act where the concept of debtor includes a transferee of the debtor's interest in the collateral.

"default" means

(a) the failure to pay or otherwise perform the obligation secured when due, or

(b) the occurrence of an event or set of circumstances whereupon, under the terms of the security agreement, the security interest becomes enforceable;

The debtor's "default" will trigger the enforcement regime established by PPSA Part 5. The meaning and relevance of the default concept is addressed in the commentary on section 56.

"document of title" means a writing issued by or addressed to a bailee

(a) that covers goods in the bailee's possession that are identified or are fungible portions of an identified mass, and

(b) in which it is stated that the goods identified in it will be delivered to a named person, or to the transferee of that person, or to bearer or to the order of a named person;

Documents of title are one of the seven categories of personal property within the PPSA collateral classification scheme. The wording of the definition of "document of title" in the Western Model PPSA clearly embraces both negotiable and non-negotiable documents whereas other versions of the PPSA including the new Ontario Act are (unintentionally) ambiguous on the point.

The meaning and relevance of "document of title" in both its negotiable and non-negotiable manifestations is discussed in detail in the commentary on section 27.

PPSA sections in which the concept of document of title is relevant include the following:

section 5	conflict of law rules governing the validity and perfection of a non-possessory security interest in an negotiable document of title
section 7	conflict of law rules governing the validity and perfection of a possessory security interest in a negotiable document of title
section 20	unperfected security interest in a negotiable document of title subordinated to a transferee for value without notice
section 22	debtor acquires possession of shipped goods at the earliest of when it acquires actual possession of the goods or a document of title to goods for the purposes of meeting the time limits imposed on secured parties for perfecting a purchase money security interest
section 24	security interest in a negotiable document of title may be perfected by taking possession
section 26	security interest in a negotiable document of title continues perfected for a temporary period notwithstanding release of possession
section 27	perfection and priority of a security interest in goods covered by a document of title.
section 31	priority of holder of negotiable document of title over security interest
section 34	when debtor obtains possession of document of title for purposes of perfection and priority of purchase money security interests in inventory
section 58	secured party's post-default enforcement rights regarding documents of title

"equipment" means goods that are held by a debtor other than as inventory or consumer goods;

"Equipment" is one of three sub-categories of goods in the PPSA collateral classification scheme. It encompasses all goods not falling within the other two sub-categories of "consumer goods" and "inventory" and essentially means commercial or business goods of a capital nature. PPSA provisions that specifically address "equipment include:

section 1	time when determination of whether goods are equipment to be made
section 7	conflict of law rules governing the validity and perfection of equipment of a type that is used in more than one jurisdiction
section 10	inadequacy of description of collateral as equipment in a security agreement

section 30	priority of buyer or lessee without notice of equipment that is not described by serial number in the registration and is defined in the regulations as serial numbered goods
section 35	perfection and priority of security interest in equipment defined in the regulations as serial numbered goods

"financing change statement" means a printed financing statement in prescribed form and, where the context permits, data authorized under the regulations to be transmitted to an office of the Registry to amend a registration;

All PPSA jurisdictions use the term "financing change statement" to denote the document prescribed for registering an amendment, discharge or renewal of a financing statement. The PPSA regulations will prescribe different forms of financing change statements for different purposes. See further Part 4 on registration and, in particular, sections 44, 45, 50 and 51.

"financing statement" means

(a) a printed financing statement in prescribed form and required or permitted to be registered under this Act, and

(b) where the context permits

(i) data authorized under the regulations to be transmitted to an office of the Registry to effect a registration,

(ii) a financing change statement,

(iii) a security agreement registered under the *Assignment of Book Debts Act*, the *Bills of Sale Act*, the *Conditional Sales Act* or the *Corporation Securities Registration Act* before the coming into force of this Act together with any writing that was registered with the agreement or to rectify, amend or renew the agreement;

All PPSA jurisdictions use the common term "financing statement" to denote the basic notice document prescribed for initial registration of a security interest. The term is defined so as to also include, where the context permits, a financing change statement used to amend, renew or discharge a financing statement.

The term financing statement may also mean registration data not contained in a printed financing statement. This aspect of the definition is designed to accommodate the possible availability of electronic remote registration in the New Brunswick PPSA registry system. See further Part 4 dealing with registration and in particular, section 43 on registration of a financing statement.

Finally, "financing statement" is deemed to include security agreements registered under the existing personal property registration statutes. This is necessary because the perfected status of existing security interests will be maintained for PPSA purposes for a transition period following proclamation of the PPSA: see further section 7_.

"fixture" does not include building materials;

While the PPSA generally does not apply to interests in land, it recognizes the hybrid character of fixtures and expressly includes them within the definition of "goods". The definition of "fixtures" itself does not in fact define the concept but is intended merely to make it clear that it excludes "building materials" as separately defined[9]. For a more detailed discussion, see section 36 which regulates priority between the competing claims of a PPSA fixtures financier and a third party with an interest in the realty to which the fixtures are attached.

> **"future advance" means an advance, whether or not given pursuant to a commitment and includes advances and expenditures made for the protection, maintenance, preservation or repair of the collateral;**

The definition of "future advance" should be read in conjunction with the definition of "advance". See also the commentary on section 14 regarding the validity of a future advance clause in a security agreement and the commentary on section 35 regarding the priority which a security interest has in relation to future advances.

> **"goods" means tangible personal property, fixtures, crops and the unborn young of animals but does not include chattel paper, a document of title, an instrument, a security, money, or trees other than crops until they are severed or minerals until they are extracted;**

For the most part, the PPSA concept of "goods" bears its ordinary meaning of all tangible personal property excluding documentary intangibles and money but including such hybrid tangibles as fixtures, growing crops, severed trees and extracted minerals[10]. For some purposes, goods are sub-divided under the PPSA into the three use categories of "consumer goods", "equipment", and "inventory" and reference should also be made to the separate definitions of these terms. PPSA provisions which specifically address collateral in the form of "goods" include:

section 3	Act applies to a commercial consignment of goods, a lease of goods for a term of more than one year and a sale of goods without a transfer of possession notwithstanding that it does not secure payment or performance of an obligation
section 5	conflict of law rules governing the validity and perfection of security interests in goods
section 6	conflict of law rules governing validity and perfection of goods where goods to be removed from jurisdiction to another within thirty days after the security interest attaches
section 7	conflict of law rules governing the validity and perfection of goods in the form of inventory or equipment that are normally used in more than one jurisdiction

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[9] The Ontario PPSA defines neither "fixtures" nor "building materials".

[10] While the definition of "goods" in the Ontario PPSA is similar to that in the Western Model, it refers to "timber to be cut and minerals and hydrocarbons to be extracted" whereas

section 12	when debtor acquires rights in goods leased or consigned to the debtor and in other specific categories of goods for the purposes of determining when the security interest attaches
section 15	law of sale of goods continues to apply to sales aspect of a purchase money financing sales transaction
section 20	unperfected security interest in goods subordinated to a transferee for value without notice
section 24	security interest in goods may be perfected by taking possession
section 26	security interest in goods continues perfected for a temporary period notwithstanding surrender of possession of the goods to the debtor for certain purposes
section 27	rules governing perfection of a security interest in goods in the possession of a third party bailee
section 27	perfection and priority in relation to goods subject to a security interest that are sold or leased and subsequently returned by the buyer or repossessed or seized by the seller
section 30	when buyer of goods takes priority over perfected or unperfected security interest in the goods
section 32	priority of repairer's lien over perfected or unperfected security interest in goods
section 36	priority between PPSA security interest in goods that take the form of fixtures and interests in the land to which the goods are affixed
section 38	priority between a security interest in accession goods and a security interest in the goods to which the accession is affixed
section 39	priority between a security interest in commingled goods and interests in the mass or whole
section 49	registration of security interests in goods that constitute fixtures in the land registry office

"instrument" means

(a) **a bill of exchange, note or cheque within the meaning of the *Bills of Exchange Act(Canada)*,**

(continued)
the Western definition makes it clear that timber and minerals constitute goods only on severance or extraction as the case may be.

(b) any other writing that evidences a right to payment of money and is of a type that in the ordinary course of business is transferred by delivery with any necessary endorsement or assignment, or

(c) a letter of credit or an advice of credit if the letter of credit or advice of credit states on it that it must be surrendered on claiming payment,

but does not include

(d) chattel paper, a document of title or a security;

(e) a writing that provides for or creates a mortgage or charge in respect of an interest in land that is specifically identified in the writing.

Instrument is a sub-category of personal property within the PPSA collateral classification scheme.

Instrument is firstly defined in its ordinary commercial sense to mean a bill, note, cheque or other writing that evidences a right to payment of money and is transferable or negotiable by delivery with any necessary endorsement.

Letters of credit and advices of credit are also expressly brought within the concept of instrument on the theory that they have acquired a quality of transferability or negotiability in contemporary commercial practice sufficient to place them within a legal regime for instruments as opposed to mere choses in action.

Chattel paper, documents of title and securities are expressly excluded from the concept of instrument. Though these writings also possess a quality of negotiability or quasi-negotiability, they do not evidence simply a right to payment and are separately defined under the Act.

See the commentary to section 4(f) regarding the exclusion of a writing that creates a mortgage of an interest in land that is specifically identified in the writing from the concept of instrument.

PPSA sections which specifically address collateral that takes the form of instruments include:

section 5	conflict of law rules governing the validity and perfection of a non-possessory security interest in an instrument
section 7	conflict of law rules governing the validity and perfection of a possessory security interest in an instrument
section 17	scope of secured party's duty of care over collateral in secured party's possession that take the form of an instrument
section 20	unperfected security interest in an instrument subordinated to a transferee for value without notice
section 24	security interest in an instrument may be perfected by taking possession
section 26	security interest in an instrument continues perfected for a temporary period notwithstanding release of possession
section 31	priority of creditor to whom instrument delivered in payment of a debt and priority of a purchaser for value over security interest in instrument

section 57	pre-default and post-default collection rights of secured party on instruments
section 60	secured party's right to dispose of instrument after default without notice

"Intangible" means personal property that is not goods, chattel paper, a document of title, an instrument, money or a security;

Intangible is a residual category of personal property in the PPSA collateral classification scheme. It is defined by exclusion to all other forms of personal property. Its most common manifestation will be an "account" (or "book debt" in current statutory parlance). But while "account" is a sub-category of "intangible", it is separately defined in section 1.

Apart from accounts, other potential species of intangibles include good will, intellectual property, licenses and quotas[11].

Specific rules governing collateral that takes the form of an intangible are found in the following sections:

section 7	conflict of law rules governing the validity and perfection of security interests in intangibles
section 8	law of the forum governs procedure for enforcement against an intangible
section 20	unperfected security interest in an intangible subordinate to the interest of a transferee for value without notice
section 22	grace period for perfection of a purchase money security interest in an intangible
section 34	priority of a purchase money security interest in an intangible
section 41	effect of assignment of intangible on rights of third party account debtor under the contract with the assignor that produced the intangible
section 57	pre-default and post-default collection rights of secured party on an intangible

"Inventory" means goods that are

(a) held by a person for sale or lease, or that have been leased by that person as lessor,

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[11] Licenses and quotas qualify as "intangibles", notwithstanding an Ontario Court of Appeal decision that the discretionary and contingent nature of a tobacco quota took it outside the scope of the old Ontario PPSA: *National Trust Co. v. Bouckhuyt* (1987) 61 OR 2d 640. The decision has been almost universally condemmed as wrong: see, for instance, G.T. Johnson, "Discretionary Licence as Collateral" (1988-89) 3 BFLR 63 - and is unlikely to take root outside Ontario.

(b) to be furnished by a person or have been furnished by that person under a contract of service, or

(c) raw materials or work in progress, or

(d) materials used or consumed in a business;

"Inventory" is one of the three sub-categories of goods in the PPSA collateral classification scheme, the other two being "consumer goods" and "equipment". In addition to the usual stock in trade for sale or lease, "inventory" is defined to encompass goods furnished under a contract of service, raw materials or work in progress and are materials used or consumed in a business. Specific rules governing collateral that takes the form of "inventory" are found in the following sections:

section 1(3)	time for determining whether goods are inventory
section 7	conflict of law rules governing the validity and perfection of inventory of a type normally used in more than one jurisdiction
section 10	adequacy of description of collateral as inventory in security agreement
section 31	priority of purchaser of chattel paper who takes possession in the ordinary course of business over security interest in chattel paper as proceeds of inventory
section 34	rules governing superpriority of purchase money security interests in inventory
section 39	priority between perfected purchase money security interest in commingled goods and non purchase money security interest in the product or mass as inventory

"lease for a term of more than one year" includes

(a) a lease for an indefinite term including a lease for an indefinite term that is determinable by one or both parties within one year from the date of its execution;

(b) a lease initially for a term of one year or less than one year if the lessee, with the consent of the lessor, retains uninterrupted or substantially uninterrupted possession of the leased goods for a period in excess of one year after the date the lessee with the consent of the lessor first acquired possession of the goods but the lease does not become a lease for a term of more than one year until the lessee's possession extends beyond one year,

(c) a lease for a term of one year or less where the lease provides that it is automatically renewable or that it is renewable at the option of one of the parties or by agreement of the parties for one or more terms, the total of which, including the original term, may exceed one year,

but does not include

(d) a lease involving a lessor who is not regularly engaged in the business of leasing goods,

(e) a lease of household furnishings or appliances as part of a lease of land where the goods are incidental to the use and enjoyment of the land, or

(f) a lease of prescribed goods, regardless of the length of the term of the lease;

For a discussion of the meaning and relevance of this definition, see the commentary on section 3 which brings "leases for a term of more than one year" within the scope of application of the perfection, priority and conflicts provisions of the PPSA, notwithstanding that they do not secure payment or performance of an obligation.

"money" means a medium of exchange authorized by the Parliament of Canada or authorized or adopted by a foreign government as part of its currency;

Money is one of seven categories of personal property within the PPSA collateral classification scheme. Money is defined to mean what everybody understands it to mean: a medium of exchange authorized by the Parliament of Canada or authorized or adopted by a foreign government as part of its currency. Specific rules governing collateral that takes the form of money are found in the following sections:

section 5	conflict of law rules governing the validity and perfection of possessory security interests in money
section 7	conflict of law rules governing the validity and perfection non-possessory security interests in money
section 24	security interest in money may be perfected by taking possession
section 28	security interest in proceeds of original collateral automatically perfected where proceeds take the form of money
section 31	priority of holder without notice of money and holder for value of money over security interest in money
section 57	secured party's right to apply money taken as collateral to satisfaction of obligation secured
section 60	right of secured party enforcing security to dispose of collateral in the form of money without notice

obligation secured" means, when determining the amount payable under a lease that secures payment or performance of an obligation,

(a) the amount originally contracted to be paid under the lease,

(b) any other amount payable pursuant to the terms of the lease, and

(c) any other amount required to be paid by the lessee to obtain ownership of the collateral,

less any amount paid before the determination;

This definition provides guidance on what constitutes the outstanding secured obligation in cases where the security agreement is cast in the form of a lease but is in substance the functional equivalent of a conditional sales agreement.

This definition is not relevant to true leases. While true leases for a term of more than one year are also brought within the scope of the PPSA by section 4, they are not subject to PPSA Part 5 which deals with enforcement rights between the parties on default and it is in this context that the concept of "obligation secured" becomes relevant.

"pawnbroker" means a person who engages in the business of granting credit to individuals for personal, family or household purposes and who

(a) takes security interests in the form of pledges to secure the credit, or

(b) purchases consumer goods under agreements or undertakings, express or implied, that the goods may be repurchased by the sellers;

A security agreement entered into with a "pawnbroker" that takes the form of a pawn or pledge of goods falls within the scope of the PPSA except for the purposes of the default enforcement regime set out in Part 5. The definition of "pawnbroker" is relevant to the exclusion from Part 5 of such transactions. See further the commentary on section 55.

"prescribed" means prescribed by the regulations;

"Prescribed" bears its technical legal meaning of prescribed under the Regulations made by the Lieutenant-Governor in Council under the authority of section 6_ of the PPSA.

"prior security interest" means an interest created, reserved or provided for under a valid agreement or other transaction entered into before [the date this Act comes into force], that is a security interest within the meaning of this Act and to which this Act would have applied if it had been in force at the time the security agreement or other transaction was entered into;

The concept of "prior security interest" refers to security interests in existence when the PPSA comes into force. It is relevant primarily to the operation of sections 72 and 73 of the PPSA which deal with its transitional application and with the transitional perfection requirements governing prior interests.

"proceeds" means

(a) identifiable or traceable personal property, fixtures and crops

  (i) derived directly or indirectly from any dealing with collateral or the proceeds of collateral, and

  (ii) in which the debtor acquires an interest,

(b) a right to an insurance payment or any other payment as indemnity or compensation for loss of or damage to the collateral or proceeds of the collateral, and

(c) a payment made in total or partial discharge or redemption of an intangible, chattel paper, an instrument or a security;

The concept of proceeds becomes relevant when collateral subject to a security interest is dealt with or otherwise gives rise to proceeds. See further:

section 1(4)	provides that proceeds are traceable without the need for a fiduciary relationship
section 10	no need for separate description of "proceeds" in security agreement for enforceability against third party
section 28	provides for the automatic continuation of a security interest in original collateral into its proceeds and states the rules governing the perfection of the security interest in the proceeds.
section 31	priority of purchaser of chattel paper in ordinary course of business for new value over security interest in chattel paper as proceeds of inventory
section 34	priority of purchase money security interest in proceeds
section 35	time for determining perfection of a security interest in proceeds for priority purposes
section 57	pre-default and post-default right of secured party to take control of proceeds to which the secured party is entitled under section 28

"purchase" means taking by sale, lease, discount, assignment, negotiation, mortgage, pledge, lien, issue, reissue, gift or any other consensual transaction creating an interest in property;

"Purchase" is liberally defined by the PPSA to encompass virtually any species of voluntary transaction that creates an interest in personal property. This broad concept of "purchase" is primarily relevant to the operation of section 31 which governs the priority of holders or purchasers of negotiable collateral, *i.e.*, instruments, documents of title, chattel paper and securities and money.

"purchase money security interest" means

(a) a security interest taken in collateral to the extent that it secures all or part of its purchase price,

(b) a security interest taken in collateral by a person who gives value for the purpose of enabling the debtor to acquire rights in the collateral, to the extent that the value is applied to acquire such rights,

(c) the interest of a lessor of goods under a lease for a term of more that one year,

(d) the interest of a consignor who delivers goods to a consignee under a commercial consignment,

but does not include a transaction of sale and the lease back to the seller, and for the purposes of this definition, "purchase price" and "value" include credit charges or interest payable for the purchase or loan credit;

The concept of "purchase money security interest" (or PMSI in popular parlance) includes not only a credit sale secured by a security interest in the very subject-matter of the sale but also a secured loan transaction where the object of the loan is to enable the debtor to acquire the very thing that is used as collateral for the loan. As such, it encompasses not only the conventional conditional sales agreement but also a chattel mortgage or charge taken to finance the buyer's acquisition of the collateral from a third party.

The definition also makes it clear that the amount secured by a PMSI includes credit charges or interest payable for the purchase price or loan credit, as the case may be, as well as the principal amount secured.

For sound policy reasons, PMSI's enjoy a privileged status in the existing law and under the PPSA. See in particular section 22 (which provides a 15 day "grace period" for the perfection of a PMSI as against the debtor's execution creditors and trustee in bankruptcy), section 34 (which awards PMSI's a super priority over other security interests in the same collateral) and section 39 (which deals with the priority of PMSI's in the context of security interests in processed or commingled goods).

The PMSI concept also encompasses the deemed security interests in goods brought within the scope of the Act under section 4. Even though such transactions do not constitute true security interests, the interest of the lessor and consignor is akin to that of the PMSI holder and ought to enjoy the same privileged status.

Transactions of sale and lease back are expressly excluded from the concept of PMSI because they involve collateral already owned by the debtor at the time of the transaction. Since they do not constitute security transactions in which the secured party's purchase or loan credit is used to enlarge the debtor's pool of assets, there is no good reason to award them privileged PMSI status.

"receiver" includes a receiver-manager;

A receiver *simpliciter* is one who receives the debtor's assets for the purposes of realizing the security interest and a receiver-manager is one who has the additional power to manage the debtor's enterprise so as to ensure a more orderly and lucrative ultimate realization of the security or even to turn the business back into a profitable enterprise. The definition of "receiver" makes it clear that both categories of receivers are included within the one term. See further section 64 which incorporates some aspects of receivership law into the PPSA default enforcement regime.

"registrar" means the Registrar of the Personal Property Registry designated under section 42;

See section 42 which provides for the appointment and powers of the Registrar of the Personal Property Registry established under the Act.

"registry" means the Personal Property Registry established under section 41;

See section 41 which establishes the Personal Property Registry for registrations required or permitted to be made by the Act.

"secured party" means

(a) a person who has a security interest,

(b) a person who holds a security interest for the benefit of another person, and

(c) the trustee, if a security interest is embodied in a trust indenture;

Just as the PPSA term "security interest" encompasses the myriad of conventional security devices recognized in the existing law, the PPSA term "secured party" encompasses the myriad of discrete labels given to those who hold particular forms of security such as chattel mortgagees, chargees, debenture-holders, and assignees of book debts.

For the sake of clarity, the concept of "secured party" is extended to include a person who holds a security interest for the benefit of another person (as in a syndicated loan arrangement) as well as the trustee if the security agreement is embodied or evidenced by a trust indenture.

"Security interest" is defined to include not only true security interests but also certain deemed security interests brought within the scope of application of the PPSA by section 4. Since "secured party" is defined to mean "a person who holds a "security interest", it follows that the concept of secured party embraces not just secured creditors but also those who hold deemed security interests even though they are not secured creditors in the ordinary sense.

It should be noted that in many of the sections relating to enforcement rights and obligations, "secured party" is defined to also include a receiver. This ensures that receivers will be equally subject to the obligations imposed on secured parties in the realization of collateral even where court-appointed and even in the face of a clause in the security agreement pronouncing the receiver to be the agent of the debtor corporation rather than the secured party.

"security" means a document that is

(a) issued in bearer or registered form,

(b) of a type commonly dealt with upon securities exchanges or markets or commonly recognized in an area in which it is issued or dealt in as a medium of investment;

(c) one of a class or series or, by its terms, divisible into classes or series of documents, and

(d) evidence of a share, participation or other interest in property or in an enterprise or is evidence of an obligation of the issuer,

and includes an uncertificated security within the meaning of the law relating to business corporations but does not include a writing that provides for or creates a mortgage or charge in respect of an interest in land that is specifically identified in the writing;

Security is one of the seven categories of personal property within the PPSA collateral classification scheme. The PPSA definition of the concept is identical to that found in section 48(2) of the *Canada Business Corporations Act*[12].

The reference to "uncertificated securities" (i.e., securities not in the form of a security certificate that are registered by the issuer in the name of a clearing agency and transferred by an entry in the records of the clearing agency) is included to accommodate their potential future use in commerce in this Province.

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[12] Unlike its federal counterpart, the New Brunswick *Business Corporations Act* retains the concept of "shares" in its Part VII ("Share Certificates, Registers and Transfers") and therefore does not define "security" separately for the purposes of that Part. It may be that the New Brunswick *Act* will require amendment in this regard to complement the PPSA.

See the commentary to section 4(f) regarding the exclusion of a writing that provides for a mortgage against land from the concept of "security".

Specific rules governing collateral that takes the form of a security are found in the following PPSA sections:

section 5	conflict of law rules governing validity and perfection of possessory security interests in a security
section 7	conflict of law rules governing the validity and perfection of non-possessory security interests in a security
section 17	scope of secured party's duty of reasonable care of collateral in the secured party's possession that takes the form of a security
section 20	unperfected security interest in a security subordinated to a transferee for value without notice
section 24	security interest in a security may be perfected by taking possession
section 26	temporary perfection of a security interest in a security notwithstanding temporary release of possession
section 31	priority of a purchaser of a security for value without notice in possession over security interest in security
section 60	when security may be disposed of by secured party after default without notice

"security agreement" means an agreement that creates or provides for a security interest, and if the context permits, includes

(a) an agreement that creates or provides for a prior security interest, and

(b) a writing that evidences a security agreement;

The opening part of the definition defines "security agreement" in its ordinary sense. Paragraph (a) of the definition then makes it clear that "security agreement" includes security agreements in existence and still current when the PPSA comes into force: see further the definition of "prior security interest". Paragraph (b) ensures that the concept of security agreement includes any writing which evidences the terms of an independently concluded security agreement rather than being the agreement *per se*.

"security interest" means

(a) an interest in goods, a document of title, a security, chattel paper, an instrument, money or an intangible that secures payment or performance of an obligation, but does not include the interest of a seller who has shipped goods to a buyer under a negotiable bill of lading or its equivalent to the order of the seller or to the order of an agent of the seller, unless the parties have otherwise evidenced an intention to create or provide for a security

interest in the goods, and

(b) the interest of

(i) a transferee under a transfer of an account or chattel paper,

(ii) a consignor who delivers goods to a consignee under a commercial consignment, and

(iii) a lessor under a lease for a term of more than one year,

notwithstanding that the interest does not secure payment of performance of an obligation;

Under section 3, the PPSA applies to all security interests in personal property regardless of form. Under section 4, the application of the Act is extended to certain deemed security interests notwithstanding that they do not secure payment or performance of an obligation. Part (a) of the definition of "security interest" relates to the true security interests under section 3 and part (b) to the deemed security interests under section 4. For a more detailed discussion, see the commentary on sections 3 and 4.

"specific goods" means goods identified and agreed upon at the time a security agreement in respect of those goods is made;

This definition relates to the definition of "chattel paper" above.

"trust indenture" means a deed, indenture, or document, however designated, by the terms of which a person issues or guarantees or provides for the issue or guarantee of debt obligations secured by a security interest and in which another person is appointed as trustee for the holders of the debt obligations issued, guaranteed or provided for under the deed, indenture or document;

See further the definition of "secured party" and see section 18 (demand for information from secured party), section 50 (discharge of registration) and section 53 (recovery of loss caused by error in the Registry where trust deeds involved).

"value" means any consideration sufficient to support a simple contract, and includes an antecedent debt or liability, and "new value" means value other than antecedent debt or liability.

The definition of "value" has particular relevance in the context of the requirement in section 12 that value be given in order for a security interest to attach. See further the discussion of the concept in the commentary on that section. The definition of value is also relevant under the various provisions which accord priority to a transferee of collateral only where she takes for value: see, for instance, sections 20, 30, 31 and 34. "New value" is separately defined to mean value other than an antecedent debt or liability. This was done for the sake of clarity because value in sections 31 and 34 is qualified by the adjective "new".

SECTION 1(2)

THE MEANING OF "KNOWLEDGE"

1(2) **For the purposes of this Act,**

(a) a natural person knows or has knowledge when information is acquired by the person under circumstances in which a reasonable person would take cognizance of it,

(b) a partnership knows or has knowledge when information has come to the attention of one of the general partners or a person having control or management of the partnership business under circumstances in which a reasonable person would take cognizance of it,

(c) a corporation knows or has knowledge when information has come to the attention of

- **(i) a managing director or officer of the corporation, or**
- **(ii) a senior employee of the corporation with responsibility for matters to which the information relates,**

under circumstances in which a reasonable person would take cognizance of it or when information in writing has been delivered to the corporation's registered office or attorney for service, and

(d) the members of an association know or have knowledge when information has come to the attention of

- **(i) a managing director or officer of the association, or**
- **(ii) a senior employee of the association with responsibility for matters to which the information relates,**
- **(iii) all members,**

under circumstances in which a reasonable person would take cognizance of it.

(e) the government knows or has knowledge when information has come to the attention of a senior employee of the government with responsibility for matters to which the information relates under circumstances in which a reasonable person would take cognizance of it.

COMMENTARY

Whether registration of a security agreement constitutes constructive notice of its existence to third parties is still unresolved in the existing law. The issue is important because of the plethora of common law, equitable and statutory rules that make priority turn on whether a subsequent interest took with notice of a prior interest.

Knowledge is far less relevant under the statutory priority regime established by Part 3 of the PPSA[13]. For the most part, the priority of a security interest will turn on whether and when it was perfected by registration or otherwise and regardless of anybody's state of knowledge or ignorance.

The state of knowledge of a transferee still remains relevant, however, in the resolution of some priority contests under the PPSA, notably: (i) the priority of an unperfected security interest as against a transferee of the collateral for value[14]; and (ii) the priority of a buyer or lessee of goods and of a holder or purchaser of negotiable collateral as against both perfected and unperfected security interests[15]. Knowledge may also be relevant for other purposes such as the obligation of a secured party to amend its registration on learning of a transfer of the collateral by the debtor[16].

Section 1(2) provides an objective test for determining when a person has "knowledge" for the purposes of these and any other provisions in which the concept is relevant.

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[13] See further the commentary on section 49 and 65.

[14] See section 20

[15] See sections 30 and 31

[16] See section 51

SECTION 1(3)

CLASSIFICATION OF GOODS COLLATERAL

1(3) **Unless provided otherwise in this Act, the determination whether goods are "consumer goods", "inventory" or "equipment" shall be made as of the time the security interest attaches.**

COMMENTARY

Goods fall into the category of "consumer goods", "equipment" or "inventory" depending on the particular use to which they are put by the particular debtor at a particular time. Thus the same goods may fall into all three categories at different points as where a van is initially purchased for family use ("consumer goods"), later converted to use as a delivery van in the family's automobile dealership ("equipment") and finally offered for sale or lease as part of the dealership stock ("inventory"). The purpose of section 1(3) is to provide guidance on when the characterization should be made for the purposes of applying those PPSA provisions which relate specifically to one or another of the sub-categories of goods. Under section 1(3), the relevant classification point is when the security interest attaches "unless otherwise provided in the Act". An example of a provision to the contrary is found in section 10(4) which provides that a description of collateral as inventory in a security agreement is adequate only so long as it is held by the debtor as inventory. See further the commentary on that section.

SECTION 1(4)

PROCEEDS TRACEABLE WITHOUT FIDUCIARY RELATIONSHIP

1(4) **Proceeds are traceable whether or not there is a fiduciary relationship between the person who has a security interest in the proceeds as provided in section 28 and the person who has rights in or has dealt with the proceeds.**

COMMENTARY

Under section 28 and the definition of "proceeds" in section 1, a security interest in collateral that is dealt with so as to give rise to proceeds continues in the proceeds so long as they remain identifiable or traceable. In a decision rendered under the old Ontario PPSA, the Ontario Court of Appeal ruled that the concept of traceable under the PPSA imports the requirement for a fiduciary relationship before the secured party will be entitled to trace[17]. The Court's ruling is out of step with contemporary views on the requirements for tracing in Canadian restitution law[18] generally and certainly has no place in a commercial setting. Section 1(4) was included in the Western Model to prevent the Ontario jurisprudence from taking root abroad.

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[17] *General Motors Acceptance Corporation v. Bank of Nova Scotia* (1986) 55 OR 2d 483 (Ont CA). See also *Re Sinco Trucking Ltd.; Paecar Financial Services Ltd v. Sinco Trucking Ltd (Trustee of)* (1989) 57 DLR (4th) 438 (Sask CA). The new Ontario PPSA fails to clarify the issue notwithstanding severe criticism: see, e.g., the case comment by J. Ziegel, "Tracing of Proceeds under the Ontario Personal Property Security Act", (1987-88) 13 CBLJ 177.

[18] See John McLaren's views in *Restitution Law in Canada* (1990)

SECTION 1(5)

INTERJURISDICTIONAL HARMONY
(Proposed Amendment to Western Model)

1(5) **In the interpretation and application of this Act, the Court shall take into account the goal of interjurisdictional harmonization of the law as a primary value.**

COMMENTARY

The Canadian common law provinces have long recognized the primary value of harmonization of legislation in a field like secured financing where both the actors and the activities frequently straddle interprovincial and indeed international boundaries. The existing New Brunswick chattel security statutes are based on uniform legislation developed by the Uniformity Commissioners of Canada who in turn borrowed in part from pre-UCC uniform American legislation developed by the National Conference of Commissioners on Uniform State Law. The decision to enact a New Brunswick PPSA was likewise fueled by the goal of harmonization, with the Western Model PPSA selected over the new Ontario PPSA at least in part because it would better serve that goal.

Harmonization of legislation is not sufficient, however, to ensure harmonization of law. Harmonization must also be carried through to the interpretation and application of the legislation at the judicial level. The drafters of the Uniform Commercial Code in the United States recognized this and provided for it expressly. Article 1-102 of the Code directs that the Code is to be liberally construed and applied to promote its underlying purposes and policies, one of which is to "make uniform the law among the various jurisdictions".

The Legislative Review Committee of the Canadian Conference on Personal Property Security Law will be asked to add a section 1(5) to the Model Act as set out above. The proposed new section is intended to promote judicial interpretation of the PPSA not as an isolated provincial act but as a statute derived from similar legislation in force elsewhere in North America. Of course, the provision will not compel a court in any one province to accept a majority line of jurisprudence from another jurisdiction which it considered to be patently wrong. The legislation itself will remain supreme. Like any other interpretative canon, section.1(5) will come into play only as an aid to resolving ambiguity and not if the legislation itself is clear on the appropriate resolution. What it is intended to do is provide a safeguard against idiosyncratic interpretations of the PPSA and to ensure that the value of interjurisdictional harmony is an influential consideration in the event of a constructional dilemma.

SECTION 2

APPLICATION TO SECURITY INTERESTS

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2 Subject to section 4, this Act applies

(a) to every transaction that in substance creates a security interest, without regard to its form and without regard to the person who has title to the collateral, and

(b) without limiting the generality of paragraph (a), to a chattel mortgage, a conditional sale, a fixed charge, a floating charge, a pledge, a trust indenture, a trust receipt, an assignment, a consignment, a lease, a trust and a transfer of chattel paper where they secure payment or performance of an obligation.

COMMENTARY

"Substance" Test for Security Interests

At common law, the creation of a security interest requires either a transfer of possession (as in a pledge) or a transfer or retention of title (as in a mortgage and conditional sale respectively). But equity "regards as done that which ought to be done". Accordingly, an agreement to charge certain property as security for a debt or other obligation will give rise to an effective security interest in equity regardless of the locus of either title or possession.

In effect, the PPSA adopts the equitable concept of security interest. Under section 2(a), all transactions that in substance create a "security interest" are brought within the scope of the Act without regard to the form of the transaction and without regard to the person who has title to the collateral[1].

This emphasis on substance over form maintains existing legislative and judicial policy. The current New Brunswick registration statutes likewise attempt to prevent secured parties from evading a registration obligation by the simple device of recasting their security agreements in a form not caught by the relevant statute. Under the *Bills of Sale Act*, for instance, the concept of "mortgage" is defined so as to include virtually any transaction, regardless of form and regardless of who has title to the collateral, that is intended to operate as a security on chattels[2]. In a similar vein, the *Conditional Sales Act* applies not only to conditional sales agreements in the classic sense but also to contracts for the hiring of goods in which it is agreed that the hirer will become or will have the option to become the owner of the goods[3]. As well, the courts have refused to adopt a technical approach to the concept of conditional sale, holding for instance that a contract on "C.O.D." terms was nonetheless a conditional sale within the meaning of the *Conditional Sales Act* where the contract also included a reservation of title clause to come into play in the event that no cash was in fact paid on delivery[4].

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[1] The original Ontario PPSA adopted the intention of the parties as the test for determining whether a transaction created a security interest. The Saskatchewan PPSA, the Western Model PPSA and new Ontario PPSA all employ a "substance" test in order to avoid any suggestion that the existence of a "security interest" depends on the parties' subjective intention as to whether the PPSA should apply to their dealings. While this conceptual change should be kept in mind in reading the jurisprudence under the original Ontario PPSA, in practice, the Ontario courts adopted a "substance" approach even under the old test. In any event, the parties' intention as objectively expressed is an important ingredient in determining the substance of any transaction.

Notwithstanding this substance over form philosophy, the existing registration statutes still require that security interests in personal property be subdivided into four discrete categories according to the type of security device, the form of the security documentation, the nature of the collateral and the status of the debtor. Mortgages, etc. on chattels are subject to the *Bills of Sale Act*, conditional sale and lease/option agreements covering chattels are subject to the *Conditional Sales Act*, assignments of book debts are subject to the *Assignment of Book Debts Act* while security interests in either chattels or book debts that are contained in a debenture or trust deed given by a corporate debtor are subject to the *Corporation Securities Registration Act*. The common law and equitable principles that regulate priority issues and enforcement remedies under existing law also depend on distinctions of title and form among security interests.

PPSA section 2(a) discards these traditional distinctions and replaces them with the concept of a single generic "security interest". This evolutionary step makes it possible to have a single comprehensive statutory regime to regulate all types of security interests in personal property. Accordingly, adoption of the PPSA will be accompanied by an express repeal of the existing registration statutes. The provisions of the Act on priorities, enforcement, etc. will also override the bulk of the equitable and common law principles that presently govern these issues.

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[2] *BSA*, section 1: " 'mortgage' includes an assignment, transfer, conveyance, declaration of trust without transfer, or other assurance intended to operate as a mortgage or pledge of chattels, or a power or authority or licence to take possession of chattels as security, or an agreement, whether or not intended to be followed by the execution of any other instrument, by which a right in equity to a charge or security on any chattels is conferred..."

[3] *CSA*, section 1: " 'conditional sale' means: (a) a contract for the sale of goods under which possession is or is to be delivered to a buyer and the property in the goods is to vest in him at a subsequent time upon payment of the whole or part of the price or the performance of any other condition, or (b) a contract for the hiring of goods under which it is agreed that the hirer will become or have the option of becoming the owner of the goods upon compliance with the terms of the contract".

[4] *WC Fast Enterprises Ltd. v. All Power Sports* (1981) 126 DLR 3d 27 (Alta CA). This pre-PPSA Alberta case was relied on by the Ontario County Court in finding that a similar reservation of title in an ostensibly "C.O.D." sales contract gave rise to a "security interest" within the meaning of the Ontario PPSA since the seller by inserting this condition intended to secure performance of the buyer's obligation to pay the purchase price in the event that no cash was paid on delivery: *Banque Nationale de Paris v. Pine Tree Mercury Sales* (1983) 3 PPSAC 51 (Ont Cty Ct). See also *Pickles Tent & Awnings Ltd. v. Joseph Group of Cos. Inc.* (1981) 2 PPSAC 1 (Man CA).

PPSA Definition of "Security Interest"

By virtue of part (a) of the definition of "security interest" in section 1[5], a transaction will create a security interest within the meaning of section 2(a) if three requirements are met.

Firstly, the transaction must create an interest in one of the following classes of property: goods, chattel paper, a security, a document of title, an instrument, money or an intangible. Each of these listed categories of property is in turn made the subject of separate definition in section 1. Collectively, these definitions cover every potential category of personal property as well as fixtures and growing crops which are defined as "goods" under the Act.

Secondly, the interest created must be a *real* interest and not a mere contractual right affecting property but not intended to affect proprietary rights in the property.

Thirdly, the transaction must create this interest for the purpose of securing the payment or performance of an obligation.

A fourth prerequisite to the application of the Act is found in the definition of "security agreement" in section 1 and the express exclusion of liens, charges and the like that arise by operation of law in section 4(a). The combined effect of these provisions is to limit the PPSA to security interests that are created by voluntary, positive, consensual agreement between the secured party and the debtor rather than automatically out of the very existence of a debtor/creditor relationship.

The extension of the PPSA to security interests in all categories of personal property will result in many more transactions being subject to a registration requirement if they are to be enforceable against third parties than obtains under the existing registration statutes. The current registration statutes require registration only where the collateral takes the form of chattels or book debts or both. Even then, there are significant exceptions. Specific assignments of book debts, for instance, are excused from registration under the *Assignment of Book Debts Act*[6]. In contrast the PPSA requires all non-possessory security interests in all forms of personal property to be perfected by registration, subject only to the specific exclusions set out in section 4.

Express Inclusion of Conventional Security Devices

For illustrative purposes, section 2(b) lists a wide array of transactions that will be subject to the Act so long as their function is to secure payment or performance of an obligation. Included are the three classic common law security devices: the chattel mortgage, the conditional sale and the pledge. Also included is the equitable charge (in either its fixed or floating manifestations) as well as a wide array of other transactional forms that are often adapted for security purposes: trust indenture, trust receipt, assignment, consignment, lease, trust and transfer of chattel paper.

Section 2(b) is a transitional provision aimed at emphasizing the application of the PPSA to the whole range of traditional security transactions. But the controlling definition of "security interest" is that found in section 1 and the controlling test is that found in section 2(a). Thus, a transaction labelled "chattel mortgage" will fall outside the Act if its true purpose is to convey absolute title rather than to secure an obligation. Conversely, a security transaction in a form not expressly listed in section 2(b) but which meets the fundamental characteristics of a "security interest" as defined in sections 1 and 2(a) will fall within the scope of application of the Act. This generic holistic approach to the concept of "security interest" makes it possible for the PPSA to readily accommodate new forms of financing without the need for further *ad hoc* legislative amendment.

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[5] Part (b) of the definition relates to the "deemed security interests" brought within the scope of application of the PPSA by section 3. See the commentary on that section.

[6] *ABDA*, section 2(b),(c).

Irrelevance of Location of Title for PPSA Purposes

The use of a substance test for security interests in section 2(a) means that the parties may either continue to draft security documentation in traditional form or may develop new security documentation under which they simply agree to create a "security interest" in collateral without further elaboration as to the nature of the proprietary interest created or intended. For the purposes of the PPSA, it makes no substantive difference which approach is adopted since the Act will treat either type of transaction as giving rise to a "security interest". However, the precise location of title may be relevant for other reasons - tax purposes, for instance, or to resolve a priority contest between a PPSA security interest and an interest not subject to the PPSA[7]. Where this is the case, it may be prudent to still include a title transfer or retention clause in the security agreement.

Interest of Seller who Reserves a Right of Disposal on Shipment not a "Security Interest"[8]

Unless the contract otherwise provides, a seller of goods relinquishes both her title and her right of lien or retention against the goods once they are delivered to a carrier for shipment to the buyer. If the purchase price has not yet been paid, this means that the seller is reduced to the status of an ordinary contract creditor. To protect themselves against the risk of non-payment, sellers (particularly in overseas transactions) may have the carrier issue the bill of lading covering the shipped goods to their own order or to the order of their agent. An order bill of lading constitutes a document of title to shipped goods and its surrender properly endorsed is necessary before the carrier will release the goods. If made out to the order of the seller or the seller's agent, a negotiable bill of lading thus enables the seller to retain the right to claim delivery of the goods and dispose of them on their arrival pending payment of the purchase price. This function is expressly recognized by section 20(2) of the *Sale of Goods Act* which provides that "[w]here goods are shipped, and by the bill of lading the goods are deliverable to the order of the seller or his agent, the seller is *prima facie* deemed to reserve the right of disposal".

Because the issuance of a bill of lading to the order of the seller effectively secures performance of the buyer's obligation to pay the purchase price of the shipped goods, it might well be construed as a transaction creating a security interest within the meaning of the PPSA. But if the PPSA were to apply to the transaction, the seller would then be obligated to observe the detailed notice, accounting, and other requirements governing the enforcement of security interests on a default set out in Part 5 of the PPSA. This would defeat the whole purpose of reserving the right of disposal which is to enable sellers to refuse delivery and efficiently resell or otherwise deal with the shipped goods at destination in the event the buyer does not pay. In view of the commercial inconvenience that would otherwise result, the absence of prejudice to a buyer who has not paid anything on the price and has never had physical possession of the goods and the absence of real risk to third party interests, there is no good reason for subjecting the arrangement to the PPSA unless the parties express some further indication that they wish it to apply. Accordingly, the definition of "security interest" in section 1 expressly excludes "the interest of a seller who has shipped goods to a buyer under a negotiable bill of lading, or its equivalent, to her own order or to the order of her agent, unless the parties have otherwise evidenced an intention to create or provide for a security interest in the goods".

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[7] For instance, in a priority contest involving a security interest under section 178 of the *Bank Act*: see *Rogerson Lumber Co v. Four Season Chalet* (1980) 1 PPSAC 160 (Ont CA).

[8] On all of the points made in the text under this heading, see further Ontario Law Reform Commission, *Report on Sale of Goods* (1979), Vol. II, at pp. 341-46, 408-415.

Unlike the Western Model, the Ontario PPSA does not expressly exclude the interest of a seller who has shipped goods to a buyer under bill of lading made out the order of the seller from the definition of "security interest". This concern is instead attempted to be addressed by section 2(2) which provides that the "rights of buyers and sellers under subsection 20(2)... of the *Sale of Goods Act* are not affected by this Act".

NOTES

SECTION 3

APPLICATION OF PPSA TO DEEMED SECURITY INTERESTS

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3 **Subject to sections 4 and 55, this Act applies to:**

(a) a transfer of an account or chattel paper;

(b) a lease for a term of more than one year; and

(c) a commercial consignment,

notwithstanding that the transfer, lease or consignment does not secure payment or performance of an obligation.

COMMENTARY

Deemed Security Interests under the Existing Law and the PPSA

The application of the existing New Brunswick registration statutes is not restricted to security interests. Registration requirements are also imposed on three types of non-security dealings in personal property. Firstly, the *Conditional Sales Act* applies to all contracts for the hiring of goods under which it is agreed that the hirer will become or have the option of becoming the owner of the goods[1]. Secondly, the *Assignment of Book Debts Act* applies to all general assignments of book debts whether absolute or by way of security[2]. Finally, an absolute sale or other transfer of chattels is subject to the *Bills of Sale Act* if the transferor remains in possession of the subject chattels even though the transfer is not intended to operate as a mortgage[3].

The PPSA likewise extends to certain non-security dealings in personal property. However, there are significant differences in the scope of the deemed security interests made subject to the PPSA by section 3. Two of the existing categories - leases and transfers of accounts - are enlarged. Two new categories are created: transfers of chattel paper and commercial consignments. A decision has yet to be made with respect to whether the *Bills of Sale* registration requirement governing a sale or other transfer of chattels without a transfer of possession should be abolished on implementation of the PPSA.

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[1] *CSA*, section 1, part (b) of definition of "conditional sale".

[2] *ABDA*, section 1, definition of "assignment". Compare the definition of "assignment of book debts" in *CSRA* section 1 which is limited to "every assignment by way of security of, and every mortgage or other charge upon book debts".

[3] *BSA*, section 3 and section 1, definition of "sale".

Leases

Lease/purchase and lease/option agreements were brought under the existing *Conditional Sales Act* in part to avoid the problem of form over substance. Otherwise, conditional sellers might have attempted to evade the registration requirements of the Act by the simple device of recasting their conditional sales agreements in the form of a chattel lease and relabeling the buyer's installment payments on the purchase price as rental payments under a lease.

Under the PPSA, this same concern is met by the use of a substance test in section 2(a) for determining whether a transaction should be characterized as a security interest. To put the matter beyond all doubt, leases are expressly mentioned in section 2(b) as an example of a form of transaction that will qualify as a security interest where they constitute the functional equivalent of a conditional sales agreement or other security rather than a true hiring.

Unlike UCC Article 9 and the Ontario PPSA, section 3 of the Western Model PPSA also brings all true leases for a term of one year or longer within its scope of application.

Two policies support the inclusion of true leases as well as security leases within the scope of the PPSA.

The first is the so-called ostensible ownership problem. Both security leases and true leases share one common characteristic: both involve a separation of ownership and possession thereby creating a potential prejudice to third parties who may deal with the lessee in the belief that possession means ownership. The imposition of a registration requirement in both cases meets this problem by ensuring that the true state of title is publicized.

The second rationale (but primary one in relative importance) is to avoid debate and litigation on the issue of whether a lease constitutes a true lease - and therefore outside the scope of the Act - or a security lease - and therefore effective against third parties including the lessee's execution creditors and trustee in bankruptcy only if registered. This issue has been a frequent source of litigation both in the United States under UCC Article 9 and in Ontario and Manitoba under the PPSA where various third parties have attacked a so-called 'lease' as an unperfected security interest and therefore subordinated for want of registration.

The jurisprudence that has grown up around the question of true lease or security lease indicates that there is no simple *a priori* test to resolve it. The old *Conditional Sales Act* test will not do. True, if the lessee is *required* by the contract to purchase the leased goods at the expiry of the agreement, then the transaction is likely to be regarded as intended to create a security interest[4]. But the inclusion of an *option* to purchase is not conclusive of its characterization as a security lease[5], at least not unless the acquisition price is so patently nominal that no reasonable lessee would fail to exercise it[6]. But if the option to purchase can be construed as being merely an option and not one which would require being exercised[7], then it may be that the lease is in a true lease despite the option. Whether this is so will require consideration of the role of the parties, the intent of the parties and the effect of the transaction[8] as determined by a consideration of such factors as: the residual value of the goods as compared to the option price[9]; whether or not the lessee is required to make up any deficiency in a final realization of the goods[10]; whether the lessee was in financial difficulty at the time of the lease[11]; whether the lessee was in the business of providing financial assistance through lease transactions[12]; and whether the subject matter of the lease was inventory of the lessor[13]. Conversely, the absence of an option to purchase in the contract is equally not conclusive of its characterization as a true lease. A lease of goods for a term equivalent to the anticipated economic or physical life expectancy of the goods could function effectively as a security arrangement without any need to include an option to purchase since the functional value of the goods would be nil in the hands of either party at the conclusion of the term.

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[4] *Re FBDB and Bramalea Ltd.* (1983) 2 PPSAC 317 (Ont HC) affirmed (1983) 150 DLR 3d 768 (Ont CA).

[5] *Re Ontario Equipment Leasing (1976) Ltd.* (1981) 1 PPSAC 303 affirmed (1982) 35 OR 2d 194 (CA)

[6] *Leaseways Autos Ltd. v. Sinco Sportswear Ltd (Trustee of)* (1986) 6 PPSAC 92 (Sask QB); *Unilease Inc v. Graphic Centre (Ont) Inc* (1982) 2 PPSAC 197 (Ont Co Ct)

[7] *Re Stark Coaxial Systems Inc* (1986) 6 PPSAC 300 (Ont SC)

[8] *Re Speedrack* (1980) 1 PPSAC 109 (Ont SC). *Re Bellini Mfg and Importing Ltd* (1981) 1 PPSAC 259 (Ont CA)

To be forced to scrutinize the particular circumstances of each case in order to know whether the PPSA applies is contrary to its intended function as a code of general principles offering *a priori* guidance. The inclusion of all true leases will avoid unnecessary litigation and ensure that doubtful or borderline cases do not escape the application of the PPSA. The experience to date under the Saskatchewan PPSA which requires that true leases be filed does not suggest that the burden has proved to be an onerous one and in neither British Columbia nor Alberta was there any real opposition to adopting the same approach. Indeed, it is not clear whether lessors in either Ontario or Manitoba are any better off under the other approach since lessors in both provinces often adopt the precautionary practice of filing all leases if any doubt exists at all on its ultimate characterization[14].

Meaning of "lease for a term of more than one year"

Only true leases that extend for a term of one year or more are deemed to be security interests subject to the PPSA under section 3. A one-year cut-off test is admittedly somewhat arbitrary. However, some concrete time period had to be arrived at in order to excuse the multiplicity of short term vehicle and equipment rentals upon which it would be commercially inconvenient and unjustifiably expensive to impose a registration requirement. The drafters of the Saskatchewan PPSA and the Western Model PPSA decided that a one year period was as good as any other for resolving the problem.

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[9] *Re 427697 Ontario Limited* (1981) 2 PPSAC 41 (Ont SC). If the option price in the agreement reflects the fair market value of the property at the time of exercise, then the option may indicate an intention that the transaction was not intended as security. An option price of 10% of the purchase price price is the usual provision in the leasing industry because it is the amount which revenue Canada is prepared to accept for income tax purposes as classifying a transaction as a lease and not a sale from the outset. However, it has been held to be inadequate as reflecting fair market value for the purposes of determining the substance of the transaction under the PPSA. Standard Finance Corporation Ltd v. Coopers & Lybrand Ltd (1984) 4 PPSAC 31 (Man QB).

[10] *Re Ontario (1976) Ltd, op cit.* If the lessee is responsible for any such deficiency, this makes the lessee effectively repsonsible for the full purchase price of the goods thereby making it likely that the transaction would be characterized as a disguised conditional sale.

[11] *Empire Stevedoring Company v. Superior Crane and Hoist Rental Ltd* (1987) 6 PPSAC 265 (Ont SC)

[12] *Gatx Corporate Leasing v. Eillism Fsy Const* (1986) 6 PPSAC 188 (Ont SC)

[13] *Price Waterhouse Ltd. v. Leggat Leasing (Halton) Ltd.* (1985) 6 PPSAC 300 (Ont SC)

[14] Professor Ziegel reports that 32.5% of Ontario commercial law practitioners surveyed stated that they "often" registered chattel leases and 17% did so "sometimes". Even more telling is his finding that 53.3% supported the inclusion of true leases under the Ontario

Further and more detailed guidance on the meaning of "lease for a term of more than 1 year" is found in the definition of that term in section 1. The definition firstly makes it clear that a lessor cannot avoid the application of the act by entering into a lease for an indefinite term determinable within one year or a lease for a term of less than one year but renewable for a series of terms that exceed 1 year. Both types of leases are expressly brought within the notion of "lease for a term of more than 1 year".

A more problematic case is one where the lease is initially for less than a year but by mutual consent the lessee ends up in possession for longer than 1 year. While this situation is also included within the definition of "lease for a term of one year", the issue of whether the PPSA applies or not clearly cannot be known except with the benefit of hindsight after the year has passed.

The definition also excludes certain types of leases which it is felt would be unnecessary or unjustifiably burdensome to subject to the registration requirements of the PPSA. A lease involving a lessor who is not regularly engaged in the business of leasing goods is specifically excused. So too are leases of household furnishings or appliances as part of a lease of land where the goods are incidental to the use and enjoyment of the land. In both cases, the nature of the lease is such as to ensure adequate public knowledge of the fact that the lessee is in possession as such and not as owner without the need for a mandatory registration requirement. Finally, the definition excludes leases of prescribed goods, permitting the exclusion by regulation of leases involving types of goods that are generally known by the public to be leased rather than owned by the person in possession. Under the Saskatchewan PPSA, this right of further exclusion has been exercised in relation to leases of telephones and telephone related paraphernalia.

Commercial Consignments

A commercial consignment enables a manufacturer, wholesaler of other supplier to offer goods for resale without ever transferring ownership to the vendor. Instead, title to the goods moves directly from the consignor as owner and principal to the ultimate purchaser with the consignee/vendor acting simply as an agent or conduit between the two.

In a true commercial consignment relationship, the consignee as agent acquires no rights in or over the goods other than the power to sell them and retain the proceeds on behalf of her principal, the consignor. Compelling *indicia* of a true consignment include the fact that the consignee is not required to pay for the goods until they are sold and the fact that the consignee may return any unsold goods to the consignor. In a true consignment, in other words, the consignor assumes the risk of a bad market.

A true consignment does not constitute a security agreement because there is no monetary or other obligation owing by the consignee that is intended to be secured by the goods as collateral[15]. However, a transaction styled a consignment may be intended in actuality to function as a 'wholesale' conditional sales arrangement in that the objective is to finance a retailer's acquisition of inventory without the need for an up-from capital investment by the retailer.

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PPSA with only 14% in positive opposition: see 5 BFLR at 33.

[15] A consignment will not be intended as security unless it secures the payment or performance of an obligation on the part of the consignee. Where the only monies owed by the consignee to the consignor are in relation to goods sold from time to time by the consignee, it follows that the remaining goods held by the consignee do not secure the payment of the monies owed by the sales and therefore the transaction does not constitute a consignment for security. *Re Stephanian's Persian Carpets Ltd* (1979) 1 PPSAC 79 (Ont SC). See also *Re*

At present, a commercial consignment which is in truth a disguised conditional sale is subject to the *Conditional Sales Act* and under the PPSA, would be caught by the substance test for "security interest" in section 2. As in the case of leases, consignments are expressly included in the list of illustrative transactions in section 2(b) to which the Act applies where the objective is to secure performance of an obligation. The result is that the consignor will have to register in order to protect the consigned goods from the consignor's execution creditors or trustee in bankruptcy and, if it wishes to gain superpriority over previously registered security interests, it will also have to give notice pursuant to section 34.

The purpose of section 3 is to also bring true commercial consignments within the scope of the PPSA. In adopting this policy, section 3 of the Western Model PPSA again departs from both the Ontario PPSA and the UCC.

The policies that favour inclusion of true commercial consignments within the scope of the PPSA are the same as though which favour the inclusion of true leases. Firstly, like leases, consignments involve a separation of title and possession and the imposition of a registration requirement ensures publicity of the true state of title. Secondly, the jurisprudence that has developed under the UCC and the Ontario PPSA[16] indicates that the distinction between a true consignment and a security consignment is one that cannot be resolved *a priori* but only after a minute scrutiny of the particular circumstances of each case. The inclusion of both true consignments and commercial consignments avoids *ex post facto* debate and litigation on the issue.

Meaning of "Commercial Consignment"

Only "commercial consignments" are brought within the scope of the PPSA by section 3. The definition of a commercial consignment in section 1 captures the traditional sense of consignment - i.e. an arrangement under which goods are delivered for sale, lease or other disposition to a consignee by a consignor who reserves an interest in the goods after they have been delivered. To be caught by the Act both the consignor and the consignee must be professionals, i.e., persons who in the ordinary course of their respective businesses deal in goods of that description.

The definition expressly excludes agreements under which goods are delivered to an auctioneer for sale and, more generally, any other arrangement where the fact that the consignee is in possession as such can be taken to be a matter of public knowledge. In such cases, the need to more formally publicize the true state of title by registration is eliminated nor is there likely to be any *ex post facto* confusion or debate on the true nature of the arrangement.

Transfers of Accounts and Chattel Paper

An assignment of accounts or of chattel paper may reflect an absolute sale or a security arrangement. As in the case of consignments and leases, the combined effect of sections 2 and 3 is to include both within the scope of the Act in order to avoid the difficulty of having to draw what is often a blurred distinction between the two types. This reflects uni-

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Toyerama Ltd (1980) 1 PPSAC 126 (Ont SC).

[16] It is worth noting, however, that UCC 2-326(3) provides that a consignment agreement under which title is reserved to the consignor until payment or resale is invalid against creditors unless registered or otherwise publicized. For this reason, the distinction between commercial and security consignments is less critical in the United States than in Ontario.

versal PPSA and UCC policy and expands existing policy in two directions. So far as transfers of accounts are concerned, while the *Assignment of Book Debts Act* at present applies to both absolute assignments and assignments by way of security, assignments of accounts due from specified debtors or growing due under specified accounts are excluded[17]. In contrast, the PPSA applies to both specific and general assignments of accounts. So far as transfers of chattel paper are concerned, there are at present no registration requirements imposed whatsoever for the simple reason that chattel paper is a new and novel category of personalty invented by the drafters of the UCC and transported to Canada with the PPSA.

Part 5 not Applicable to Deemed Security Interests

The deemed security interests listed in section 4 are subject only to the conflict of laws, perfection and priority provisions of the PPSA. For obvious reasons, the application of the Part 5 default enforcement regime is excluded. Accordingly, a court may still be faced with the difficult task of distinguishing between true leases and consignments and security leases and consignments where the application of Part 5 is in issue.

"Secret" Bills of Sale

Like its present and former counterparts in England and in other Canadian provinces, the New Brunswick *Bills of Sale Act* applies to all transfers of chattels - whether absolute or by way of security - if the transferor remains in possession[18]. Under section 3 of the *Act*, a sale or mortgage of chattels that is not accompanied by an immediate delivery and an actual and continued change of possession is void as against a creditor and as against a subsequent purchaser or mortgagee claiming in good faith for value and without notice unless registered.

When Ontario first enacted its PPSA, it simultaneously repealed the chattel mortgage aspect of its *Bills of Sale and Chattel Mortgages Act* for the obvious reason that chattel mortgages were to be subsumed along with all the other traditional security devices within the PPSA's generic concept of "security interest". However, the absolute sales aspect of the *Act* was retained and reenacted as the *Bills of Sale Act*[19]. The new *Act* continued the registration requirements for absolute sales but changed the registration venue to the Personal Property Registry established under the PPSA.

The decision to retain a registration requirements for bills of sale absolute was not made without controversy. In its 1979 *Report on the Sale of Goods*, the Ontario Law Reform Commission concluded that the Act had outlived its usefulness and could safely be repealed. Whatever may have been the position in the nineteenth century, the Commission felt that it was no longer unusual for a seller to remain in possession of goods after they had been sold. It was the Commission's impression that the registration requirements of the Act were widely ignored in practice and its inquiries among trustees in bankruptcy and lenders had found no opposition to their repeal.

The Commission's point of view found fertile ground in the west and when Manitoba and Saskatchewan subsequently adopted their PPSA statutes, the decision was made to repeal the bills of sale legislation in its entirety. Alberta and British Columbia followed suit and in its 1989 PPSA, Ontario finally repealed its own *Bills of Sale Act*, apparently in reaction to the hardship suffered by buyers from a boat dealer who became bankrupt before delivering the boats for which he had already been paid. The buyers lost their purchase money advances to the trustee in bankruptcy because of their failure to register under the *Bills of Sale Act*.

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[17] *ABDA*, section 2(b),(c)

[18] See further the commentary on section 19.

[19] RSO 1970, c. 44, as amended

The repeal of the bills of sale legislation in these jurisdictions means that a buyer out of possession need no longer be concerned with registering in order to ensure enforceability against the seller's execution creditors, secured creditors and trustee in bankruptcy. Registration remains necessary, however, to protect the buyer out of possession against the effect of the *Sale of Goods Act* provisions which empower a seller who remains in possession of goods after they have been sold to convey good title to a subsequent transferee for value without notice. The *Sale of Goods Acts* of Saskatchewan, Alberta and British Columbia have all been amended to permit registration in the PPSA registry for this purpose.

Repeal of the Absolute Bills of Sale Aspect of the Bill of Sale Act Philosophy in New Brunswick?

Should New Brunswick follow the now universal example set by other PPSA jurisdictions and also repeal the absolute sales aspect of the bills of sale legislation on enactment of the PPSA?

In favour of repeal, it is argued that buyers who temporarily delay taking possession of the goods they have purchased should not lose out to the seller's execution creditors or bankruptcy trustee for failure to register since the latter should reasonably expect that at least some of the goods in a merchant's hands have already been made the subject matter of a sale. However, unlike its Ontario and western counterparts, the New Brunswick *Bills of Sale Act* already recognizes this problem and resolves it satisfactorily. Ordinary course sales are exempted from the registration requirement. It is only sales that occur out of the ordinary course of business that must be registered if the seller does not relinquish possession of the relevant goods. And it is of course the non ordinary course transfer which is most apt to mislead third parties as to the true state of title or indeed involve the kind of sharp practice aimed at hindering or defeating the debtor's execution creditors, these being the two concerns which the public registration requirement is aimed at redressing[20]. It is true of course that the vendor's unsecured creditors and trustee in bankruptcy do not rely on their debtor's apparent ownership of assets in his or her possession in the same way as do purchasers and other transferees for value. However, there is still an element of reliance in so far as a creditor may delay taking judgment or initiating execution in the false belief that the presence of assets means that there are no immediate concerns with solvency. Moreover, the right to sue to set aside the transfer on the basis that it constitutes a fraudulent conveyance or false preference is no substitute for the protection which the public registration requirement offers against the temptation to engage in such transfers. Few such suits succeed because of the heavy burden of proof cast on the plaintiff nor is it worth the time and expense to most judgment creditors to bring suit in the first instance.

In the absence of a persuasive case for concluding that the absolute sales aspect of the *Bills of Sale Act* no longer performs a useful function, it is recommended that there be further input and discussion before a final decision is made on whether the legislation should be retained, abolished or transferred to the deemed security interest provisions of PPSA section 4.

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[20] See further the commentary on section 19.

NOTES

SECTION 4

EXCLUSIONS FROM APPLICATION OF ACT

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4 Except as otherwise provided in this Act, this Act does not apply to the following

(a) a lien, charge or other interest given by statute or rule of law,

(b) the creation or transfer of an interest or claim in or under a contract of annuity or policy of insurance except the transfer of a right to money or other value payable under a policy of insurance as indemnity or compensation for loss of or damage to collateral,

(c) the creation or transfer of an interest in present or future wages, salary, pay, commission or any other compensation for labour or personal services other than fees for professional services,

(d) the transfer of an unearned right to payment under a contract to a transferee who is to perform the transferor's obligations under the contract,

(e) the creation or transfer of an interest in land including a lease,

(f) the creation or transfer of a right to payment that arises in connection with an interest in or lease of land other than a right to payment evidenced by a security or instrument,

(g) a sale of accounts or chattel paper as part of a sale of a business out of which they arose unless the vendor remains in apparent control of the business after the sale,

(h) a transfer of accounts made solely to facilitate the collection of accounts for the transferor,

(i) the creation or transfer of a right to damages in tort,

(j) an assignment for the general benefit of creditors made pursuant to an Act of the Parliament of Canada relating to insolvency,

(k) a security agreement governed by an Act of the Parliament of Canada that deals with the rights of parties to the agreement or the rights of third parties affected by a security interest created by the agreement, including but without limiting the generality of the foregoing,

(i) any agreement governed by Part V, Division B of the *Bank Act* (Canada), and

(ii) a mortgage under the *Shipping (Canada)* Act.

COMMENTARY

(a) A lien, charge or other interest given by statute or rule of law[1]

In general, the PPSA only applies to *consensual* security transactions[2] in personal property. Section 4(a) expressly confirms the exclusion of "a lien, charge or other interest given by statute or rule of law" from the scope of application of the PPSA.

New Brunswick statutory and common law currently recognizes a wide array of both possessory and non-possessory non-consensual liens, charges and other *real* interests in personal property, including the following:

Possessory Liens:

> *Solicitors, stockbrokers, bankers and factors*[3] have a common law general lien exercisable over all of the debtor's goods in their possession whether or not the debt relates to work done on those goods.
>
> *Innkeepers* also enjoy a common law general lien on the baggage and property of their guests for the value of any food or accommodation furnished to the guest. The innkeeper's right of lien is codified in section 2 of the New Brunswick *Innkeepers' Act*.
>
> *Repairers, storers, wharfingers and others who furnish services or materials in relation to a chattel* have common law lien for their charges. The lien is a particular lien, that is to say it is exercisable only against the particular chattel in respect of which the relevant services or materials were furnished. In New Brunswick, the law governing repairer's, wharfingers and storer's liens has been codified and supplemented by statute: see the *Liens on Goods and Chattels Act* and the *Warehouseman's Lien Act*.
>
> An *unpaid vendor of goods* has a lien against the goods for the price under sections 37-40 of the New Brunswick *Sale of Goods Act* so long as the goods remain in the vendor's possession.
>
> A *person who finds an animal at large, or who arrests a person found violating the criminal law respecting cruelty to animals* has a lien under section 8 of the *Society for the Prevention of Cruelty Act* on the animal for the expenses of its care.
>
> A *landlord* has the right at common law to levy distress against goods on the tenant's premises for arrears of rent. The common law right of a landlord to levy distress is codified in sections 20-37 of the *Landlord and Tenant Act*[4] which also

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[1] For an analysis of the rationale supporting the exclusion of nonpossessory stautory liens in particular, see Bogart, "Statutory Claims and Personal Property Security Legislation: A Proposal" (1983-84) 8 Can Bus L J 129.

[2] See definition of "security agreement" in section 1 and the commentary accompanying section 3.

[3] Note also section 10 of the *Factors and Agents Act* which provides that where the owner of goods has given possession to another for the purposes of consignment or sale, or has shipped goods in the name of another person, and the other person does not have notice that such person is not the owner of the goods, and the consignee has no notice that such person is not the owner, the consignee has the same lien on the goods as if the person were owner.

[4] SNB Chap L-1, sections 20-37.

regulates its manner of enforcement, confers a statutory right to sell the distrained goods and delimits the scope of the property liable to distress. Like the foregoing liens and charges, the right to distrain for unpaid rent arises by operation of law out of the relation of landlord and tenant. It has therefore been held in PPSA jurisdictions that the right of distress constitutes a "lien, charge or other interest given by statute or rule of law" falling outside the scope of the PPSA, at any rate once there is an actual or constructive taking of possession of the distrained goods[5].

Non-possessory liens:

Under the *Employment Standards Act*, employees have a lien for unpaid wages against the employer's real and personal property where the Director appointed under the Act has reason to believe that the employer is insolvent or on the eve of insolvency.

Under sections 2 and 3 of the *Woodsmen's Lien Act*, woods workers and saw mill workers respectively have a lien on the logs, timber and lumber in respect of which they have performed labour or services for the amount due for the labour or services.

Under section 72 of the *Workers Compensation Act*, the Workers' Compensation Board has a lien for unpaid assessments on all present and future property, real personal or mixed, used in or in connection with or produced in or by the industry with respect to which the employer is assessed though not owned by the employer. While the lien is extinguished on a bona fide sale of the business made in the ordinary course of business, the Board has a charge on the proceeds of the sale or disposition.

Under section 25 of the *Revenue Administration Act*, the Crown in right of the Province has a lien against any goods in respect of which a tax is imposed under a provincial revenue act for the amount of unpaid taxes and, where the goods are sold, the amount of the lien constitutes a charge on the proceeds of sale. Furthermore, every collector who collects a tax is deemed to hold it in trust for the Crown and the amount forms a special lien on the entire assets and on all property used in or in connection with or produced by the business of the collector.

Under section 22 of the *Metallic Minerals Tax Act*, the Crown in right of the province has a "special lien and charge" for the amount of an unpaid annual tax on the revenues derived from mining operations in New Brunswick on the said revenues, the land occupied by the mine, the minerals or mineral products taken from the mine and all machinery on or connected with the land occupied by the mine.

A wide variety of non-consensual liens and charges have also been created under federal statutory law and these too are within the section 4(a) exclusion. However, since it is constitutionally impossible for New Brunswick to enact legislation integrating PPSA law with federally-regulated interests, nothing more will be said about them here. In relation to provincial non-consensual interests, however, some integration is both possible and desirable.

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[5] See *Dube v. Bank of Montreal* (1986) 7 PPSAC 223 (Sask CA) On the latter point, see *Commercial Credit Corporation Ltd. v. Harry D. Shields Ltd.* (1980) 1 PPSAC 99 (Ont High Ct.) affirmed (1981) 32 OR 703 (Ont CA)

Registering Non-possessory Liens in the Personal Property Registry:

If a lien or charge is non-possessory, problems of public notice arise. Existing New Brunswick law therefore imposes, at least in the case of non-possessory liens in favour of private creditors, some form of public registration requirement in order to ensure that third parties are alerted to the existence of the lien:

> The employee's lien for unfiled wages under the *Employment Standards Act* takes effect only on filing of a certificate stating the amount of unpaid wages in the registry office for the county or counties where the employer carries on business. The lien is indexed in an "Employees' Lien Index" maintained by the Registrar of Deeds and attaches to all the real and personal property of the employer situate in the county or counties in which the certificate is filed. Certificates are issued by the Director appointed under the Act where satisfied that the employer is insolvent or on the eve of insolvency and that the wages owing are likely to remain unpaid.
>
> The liens in favour of woods and saw mill workers under the *Woodsmen's Lien Act* do not attach or remain liens unless a statement of lien is filed in the office of a clerk of the Court of Queen's Bench of New Brunswick within thirty days and twenty days respectively after the labour or service was performed.

In PPSA jurisdictions, the PPSA Registry has been adopted as a convenient 'one-stop shopping' registration venue for personal property interests not governed by the PPSA. The same approach will be taken in New Brunswick. Contemporaneously with the enactment of the PPSA, the *Woodsmen's Lien Act* will be amended to substitute the Personal Property Registry as the appropriate registration venue for woods and saw mill workers liens. Since the lien under the *Employment Standards Act* attaches to both real and personal property, it will still have to be filed in the land registry office so far as the real property is concerned. However, the Act will be amended to make the Personal Property Registry the appropriate registration venue on the personalty side.

Unlike the non-possessory statutory liens in favour of private creditors, those in favour of the Crown or a Crown agency do not require registration in order to take effect. On the contrary, section 26 of the *Revenue Administration Act* expressly stipulates that the lien attaches on the date the tax is collected, does not require registration or filing of any document or the giving of notice to any person to create or preserve it, attaches to all future property, and follows the property into whosoever hands the property comes.

Whether the Crown should continue to be immunized from the registration burden imposed on both consensual and non-consensual private creditors has been a controversial question for some time[6]. Under the existing New Brunswick law, there are significant gaps in the system of mandatory registration for non-possessory security interests applicable to private creditors. But the advent of a PPSA regime will mean near universality of registration for all private creditors. This being the case, a number of PPSA jurisdictions have begun to move towards imposing at least a qualified registration requirement for non-possessory Crown liens. Indeed, such reforms end up benefiting the Crown since the ability of third parties to search a public registry reduces the inquiry burden on it. It is therefore recommended that the existing Crown lien legislation be amended so as to require registration of the various liens in the PPSA registry once it is operational.

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[6] See Bogart, "Statutory Claims and Personal Property Security Legislation: A proposal" (1983-84) 8 Can Bus L J 129

Priority between PPSA Security Interests and Non-PPSA liens

Integration between PPSA security interests and non-PPSA liens is also necessary for the purposes of determining priority between them. PPSA section 32 provides a general priority rule where a PPSA security interest on goods comes into competition with a lien on the same goods that arises as the result of the provision in the ordinary course of business of materials or services in respect of the goods. Under section 32, the lien enjoys a superpriority over either a perfected or an unperfected PPSA security interest "unless the lien arises under an act that gives priority to the security interest". The rationale for this superpriority and its interrelationship with the statutory law governing such liens is discussed in detail in the commentary to section 32.

Section 32 aside, the PPSA does not attempt to resolve priority between PPSA security interests and non-PPSA liens and charges. The relevant priority rules are instead to be found in the common law and statutory principles that have developed around the particular lien. On enactment of the PPSA, these priority rules will also be amended or revised to take account of PPSA terminology and contemporary commercial policy. In particular:

Priority between PPSA Security Interests and Innkeepers Liens

At common law, an innkeepers' lien extended to the baggage and property of a guest brought on to the premises whether it belonged to the guest or not. Accordingly, the innkeeper's lien took priority over any third party interests in the liened goods. It has been held in Ontario that the *Innkeepers Act* does not restrict the scope of the lien in this respect. Therefore, the lien took priority over a security interest in the guest's property (a car) that had been registered under the Personal Property Security Act[7].

The rationale for the common law superpriority of the innkeeper's lien lay in the innkeeper's common law obligation to provide the necessaries of life - food and shelter - to all comers and his or her relative lack of practical opportunity to make inquiry as to title. In contemporary commercial life, these considerations no longer hold the power they once did. The innkeeper's decision to extend credit is or should be made on the guest's proof of personal creditworthiness - cash or credit card - rather than the value of the baggage in train. Accordingly, it is proposed that the *Innkeeper's Act* be amended to restrict an innkeeper's lien to the guest's beneficial interest in property and baggage brought on to the premises and to provide expressly that the lien is subordinate to a security interest in the property and baggage that has been perfected under the *Personal Property Security Act* when the innkeeper's lien attaches.

Priority between PPSA Security Interests and Landlord's Right of Distress

Under section 34 of the *Landlord and Tenant Act*, a landlord's right of distress is limited to goods and chattels found on the premises that belong to the tenant with certain exceptions that include goods claimed by another by virtue of a mortgage from the tenant. The landlord's right of distress, in other words, is given priority over a mortgagee's security interest in the distrained chattels[8]. A conditional vendor's security interest in goods held by the tenant under a conditional sale or hire agreement, on the other hand, is immune from distress provided the agreement is duly filed under the *Conditional Sales Act*[9].

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[7] *Bank of Montreal v. 414031 Ontario Ltd. c.o.b. Red Dog Inn* (1983) 2 PPSAC 248

[8] For judicial confirmation of the effect of the statute on this point, see *Stott v. Heninger* [1935] SCR 408.

[9] s. 34(e). The landlord's right of distress is limited to the tenant's "equity" in the

In Ontario, the pre-PPSA terminology of section 31 of the *Landlord and Tenant Act*, being the counterpart to section 34 of the New Brunswick Act, was left unchanged following the passage of both the old and the new PPSA's. This left the courts in that province with a difficult interpretative task in attempting to apply section 31 to resolve a priority dispute between a landlord and the holder of a PPSA security interest in the distrained chattels. No doubt, the term "chattel mortgage" as used in section 31 can readily be analogized to the term "security interest" in the PPSA so as allow the landlord to retain its pre-PPSA priority. This in fact is the approach that the Ontario courts have taken[10]. But what if the security interest in competition takes the form of a purchase money security interest. While section 31 gives priority to a conditional seller over the landlord, the PPSA concept of a "purchase money security interest" also extends to a security interest taken by a lender who provides funds to enable the debtor to acquire the collateral. Yet there is no good reason why a PMSI in the form of a conditional sale should take priority over the landlord but not a PMSI which takes the form of a chattel mortgage.

To avoid the Ontario experience requires translation of the basic policy underpinning section 34 to accommodate post-PPSA terminology. Accordingly, the *Landlord and Tenant Act* will be amended to provide that goods subject to a security interest within the scope of the PPSA will remain liable to distress by the debtor's landlord except where the security interest takes the form of a purchase money security interest that has been duly perfected under the PPSA.

Integrating PPSA and non-PPSA Enforcement Regimes:

The enforcement regimes governing non-consensual liens and charges are currently stated in the statutes governing the particular interest. Occasionally, these statutes integrate the enforcement of a non-consensual security interest with the enforcement process for chattel mortgages, etc. While the same approach will be adopted when the PPSA is introduced, the terminology of these statutes will have to be amended to take account of the PPSA terminology and conception of security and the enforcement procedures themselves modernized.

(b) the creation or transfer of an interest or claim in or under a contract of annuity or policy of insurance except the transfer of a right to money or other value payable under a policy of insurance as indemnity or compensation for loss of or damage to collateral

Interests under annuities or life insurance and other policies are sometimes used as loan collateral. Such transactions were, however, excluded from the scope of the UCC on the ground that they are quite special, do not fit easily under a general commercial statute and are adequately covered by existing practice. All of the Canadian PPSA's, including the Western Model, have adopted the same policy.

However, the security agreement will inevitably require that the debtor's right to indemnity under an insurance contract covering the collateral be assigned over to the secured party, Section 4(b) makes it clear that the exclusion applies only to the creation of a security interest in the insurance policy itself and does not extend to a clause in a security agreement

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(continued)
goods subject to the conditional sales contract: *Carroll v. Beard* (1896) 27 OR 349 (Ont CA).

[10] *Commercial Credit Corp Ltd v. Harry D Shields Ltd* (1980) 29 OR (2d) 106 affirmed (1981) 32 OR 2d 703 (Ont CA)

which is meant to provide the secured party with further protection by requiring the debtor to insure the collateral. It should also be noted that where insurance monies are payable for loss of or damage to collateral that is subject to a PPSA security interest, they fall within the definition of proceeds in section 1 and may be claimed by the secured party as such pursuant to section 28(1).

(c) the creation or transfer of an interest in present or future wages, salary, pay, commission or any other compensation for labour or personal services other than fees for professional services

For reasons of social policy, many legal systems restrict the assignability of wages, etc. as security for debts incurred by the wage earner. It is because of this that most PPSA's, a notable exception being Ontario's[11], exclude wage transfers from their scope of application. The extent of the exclusion in a particular jurisdiction depends on the extent of the prohibition against wage assignments in that particular jurisdiction.

In New Brunswick, the prohibition on wage assignments by way of security is fairly comprehensive. Section 38 of the *Employment Standards Act* provides that "any assignment of wages or any portion thereof made after the section comes into force and used as security for the payment of a debt is invalid"[12]. Under the definition found in section 1 of the *Act*, "'wages' includes salary, commissions and compensation in any form for work or services measured by time, piece or otherwise..." The scope of the exclusion of wage transfers set out in section 4(d) of the proposed PPSA is meant to track this wording. Section 38 of the *Employment Standards Act* will, in turn, need minor consequential amendment to accommodate the terminology introduced by the PPSA as well as to clarify that the assignment of professional fees is not prohibited.

(d) the transfer of an interest in an earned right to payment under a contract to a transferee who is to perform the transferor's obligations under the contract

Assignments of debts, whether absolute or by way of security, are brought within the PPSA by sections 3 and 4 because of the need to publicize to third parties that the debtor not longer has the "property" in the debt. Since the debt is an intangible incapable of being reduced into concrete physical possession, mandatory registration is the only practical method of publicizing the transfer. However, section 4(e) excludes from the scope of the Act a contract of assignment which contemplates that the transferee of a contract debt that has not yet been earned by performance is to step into the shoes of the transferor for the purposes of performing the contractual obligation. Such an "assignment" amounts to a novation of the contract in that the assignee is intended to completely replace the assignor as the contracting party. In a contractual novation of this sort, there is little likelihood that a third party would be misled into the belief that the debt was still owned by the transferor and there is therefore no good reason for subjecting it to the registration and other perfection requirements of the PPSA.

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[11] It is clear that in the absence of an express exclusion, a wage assignment falls within the definition of "security interest": see *Re Beaton* (1978) 91 DLR (3d) 755 (Ont SC) reversed on other grounds (1979) 1 PPSAC 58 (Ont CA)

[12] Assignments of wages etc due or becoming due from the Province are the subject of a separate regulation in the *Financial Administrtion Act*. Section 51(1) of the Act expressly recognizes the validity of an absolute assignment of Crown debts provided notice of the assignment has been given to the Comptroller at Fredericton. However, section 51(1) is subject to subsection (3) which provides that "[a]ny amount due or becoming due by the the Province as salary, wages, pay or pay and allowances is not assignable".

(e) the creation or transfer of an interest in land including a lease

Section 4(g) expressly reconfirms the exclusion of real estate mortgages, real estate leases, real estate agreements of sale and all forms of security in land generally from the scope of the PPSA. However, no legal category is capable of absolute demarcation and there are several categories of property interests in the borderland between real and personal property which are subject in whole or in part to regulation under the PPSA. These include fixtures (see further section 36) and growing crops (see section 37).

(f) the creation or transfer of a right to payment that arises in connection with an interest in or a lease of land other than a right to payment evidenced by a security or instrument

The commentary on this exclusion is not yet completed.

(g) a sale of accounts or chattel paper as part of a sale of a business out of which they arose unless the vendor remains in apparent control of the business after the sale

Section 2(d) of the existing New Brunswick *Assignment of Book Debts Act* expressly excludes "an assignment of book debts included in a transfer of business made *bona fide* and for value" from the registration requirements of the *Act*. Such assignments generally pose no risk of deception to third parties who can be expected to appreciate that the sale of a business normally involves the transfer of all business assets to the new owner, including the current book debts. There is accordingly no need to require that the transaction be publicized. To this, there is one exception. If the seller remains in apparent control of the business after the sale, third parties are unlikely to appreciate that a transfer of business assets, including the book debts, has taken place. Accordingly, while PPSA section 4(g) maintains the existing statutory policy in generally excluding "a sale of accounts or chattel paper as part of a sale of the business out of which they arose" from the scope of the PPSA, the transfer will be subject to the Act if the "vendor remains in apparent control of the business after the sale".

(h) a transfer of accounts made solely to facilitate the collection of accounts for the transferor

The commentary on this exclusion is not yet completed.

(i) the creation or transfer of a right to damages in tort

The commentary on this exclusion is not yet completed.

(j) an assignment for the general benefit of creditors made pursuant to an Act of the Parliament of Canada relating to insolvency

The commentary on this exclusion is not yet completed.

(k) security Interests under Section 178 of the Bank Act

The Origins and Scope of Section 178 Bank Act Security[13]:

Section 178 of the federal *Bank Act* empowers the chartered banks to loan money on the security of a borrower's present and after-acquired tangible personal property and establishes a registration, priority and enforcement regime to govern the rights of the bank and borrower *inter se* as well as against certain third parties. Originally restricted to primary products and primary producers, the scope of *Bank Act* security was expanded in 1980 to encompass virtually every class of business debtor and virtually every form of tangible personal property.

While the registration requirement was not added until 1923, the fundamental features of *Bank Act* security are rooted in pre-Confederation Upper Canadian banking legislation. The historical policy reasons for the creation of a national uniform security interest were recently reviewed by Justice La Forest on behalf of the Supreme Court of Canada in *Bank of Montreal v. Hall*[14]. He reconfirmed the conventional wisdom that *Bank Act* security was introduced in order to overcome the barriers to the availability of capital created by the complexity, diversity and rigidity of provincial lending regimes. Parliament had acted, in other words, not so much to benefit banks but to encourage manufacturing and commercial enterprise in the nascent Canadian economy by providing an accessible nationwide system for secured financing. Largely because of these historical policy justifications, he reconfirmed that the *Bank Act* provisions governing section 178 "fell squarely within the limits of the federal banking power" and were constitutionally valid.

The Interrelationship between Federal Bank Act Security Law and Provincial Personal Property Security Law[15]:

It is not uncommon for collateral subject to *Bank Act* security in favor of a chartered bank to be also subject to a provincially-created security interest in favor of another financier. While this situation creates obvious potential for a priority contest, the existing New Brunswick personal property security law is in fact relatively compatible with the *Bank Act* approach to priorities. Under both the federal and provincial regimes, the principle of priority expressed in the maxim *nemo dat quod non habet* has been qualified by a statutory registration requirement with complementary priority repercussions. Should a bank fail to register its section 178 security under the *Bank Act*, its interest is voided as against creditors and as against subsequent mortgagees and purchasers of the collateral. Under the existing New Brunswick chattel security registration acts[16], failure to register has the same consequence and the courts have held that a bank holding section 178 security interest is a "subsequent mortgagee" within the meaning of these acts against whom an unregistered provincial chattel mortgage or other security device will likewise be void.

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[13] For a recent general discussion, see William D. Moull, "Security under section 177 and 178 of the Bank Act" (1986) 65 Can Bar Rev 242

[14] *Bank of Montreal v. Hall* [1990] 1 SCR 121 (1990) 65 DLR 4th 361

[15] The issues in this area have spawned a still-growing literature: see R.C.C. Cuming and R.J. Wood, "Compatibility of Federal and Provincial Property Security Law (1986) 65 Can Bar Rev 267; J.S. Ziegel, "Interaction of Personal Property Security Legislation and Security Interests under the Bank Act" (1986-87) 12 CBLJ 73; R.C.C. Cuming, "The Relationship between Personal Property Security Acts and Section 178 of the Bank Act: Federal Paramountcy and Provincial Legislative Policy" (1988) 14 CBLJ 315; Bradley Crawford, "Must a Bank comply with Provincial Legislation when Enforcing a Bank Act security?" (Case Comment) (1991) 70 Can Bar Rev 142.

[16] *i.e., Bills of Sale Act, Conditional Sales Act, Assignment of Book Debts Act, Corpora-*

However, the relative harmony which now exists between provincial personal property security law and the federal *Bank Act* provisions on security will disappear with the enactment of a *Personal Property Security Act* by New Brunswick. It is true that, like the existing provincial registration acts, a PPSA also subordinates an unregistered security interest to competing third party security interests in the same collateral. But in contrast to the existing acts, a PPSA is intended in general to regulate rights and priorities only as among parties who are themselves subject to the general scheme of the Act.

The implications of this new approach were revealed in *Rogerson Lumber Co. Ltd. v. Four Seasons Chalet Ltd.*[17] when a majority in the Ontario Court of Appeal ruled that an unregistered or otherwise unperfected security interest created under provincial law is subordinated only as against security interests also governed by the PPSA. As against a section 178 security interest, the failure to register or otherwise perfect a PPSA security interest is irrelevant for the purposes of asserting priority. Nor does federal law assist the bank. Under the *nemo dat* priority approach incorporated in the *Bank Act*, the bank takes subject to any pre-existing third party proprietary interests against the collateral whether or not registered under provincial requirements.

As a result of the *Rogerson Lumber* decision, a bank taking section 178 security in PPSA jurisdictions cannot rely with confidence on the provincial registry system to determine whether there exist any outstanding security interests in the collateral. Provincial lenders do not face the same problem vis a vis the section 178 lender. The *Bank Act* continues to subordinate an unregistered section 178 interest as against subsequent mortgagees of the collateral which obviously means secured parties taking a security interest under provincial law.

In the wake of the *Rogerson Lumber* decision, chartered banks in PPSA jurisdictions began to register their section 178 interests under both the *Bank Act* and the PPSA. Some went further, simultaneously taking and registering both *Bank Act* security and PPSA security with separate and complete documentation for each. They hoped that registration would give them the priority advantages of PPSA law, and in particular priority as against unregistered PPSA interests. Judicial reaction to these practices has been confused and mixed. While the Ontario Court of Appeal has ruled that a section 178 interest may indeed be registered as a "security interest" under the Ontario PPSA, it has also ruled that a bank cannot use its PPSA registration to give it a better priority status than it has under the *Bank Act*[18]. The Saskatchewan Court of Appeal has also addressed the issue in a case where the bank had not merely registered its section 178 security interest under the PPSA but had executed parallel security documentation in accordance with both the *Bank Act* and the PPSA. The Court ruled that this practice could indeed be used by the banks to give them the advantage of both the PPSA and *Bank Act* legal regimes[19].

The jurisprudential confusion would of course be resolved were PPSA jurisdictions to simply amend their PPSA's so as to expressly protect section 178 interests as against unregistered and otherwise unperfected provincial security interests. But this they have been unwilling to do. On the contrary, section 4(k) of the Western Model PPSA expressly excludes section 178 interests from the scope of the PPSA. It is not that these jurisdictions are

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tion Securities Registration Act.

[17] (1981) 113 DLR (3d) 671 (Ont CA)

[18] *Bank of Nova Scotia v. International Harvester Credit Corporation of Canada Ltd.* (1990) 74 OR 2d 738 (Ont CA)

[19] *Birch Hills Credit Union Ltd. v. Canadian Imperial Bank of Commerce* (1988) 52 DLR 4th 113 (Sask CA)

unsympathetic to the plight of the bank who wishes to be able to rely on the information in the provincial PPSA registry in deciding whether or not to advance funds pursuant to *Bank Act* security. However, it is felt that banks using federal *Bank Act* security should not be able to take the benefit of the PPSA priority regime without also accepting its burdens. And, as matters stand presently, the section 178 priority regime occasionally protects the bank as against provincially created security interests in a manner that conflicts with PPSA priority policies.

A PPSA, for instance, generally awards priority to the secured party who first registers or otherwise perfects its security interest regardless of the order of creation (attachment) of the competing interests. However, priority under the *Bank Act* is ordered according to the principle of *nemo dat quod non habet* or, in the case of after-acquired property where the competing federal and provincial interests can be seen as attaching simultaneously, according to the order in which the security instruments are executed[20]. The doctrine of paramountcy means that the *Bank Act* priority policy prevails with the result that a section 178 security interest takes ahead of even a prior-registered PPSA interest if the PPSA interest has not yet attached at the date that the section 178 security interest is taken. The result clearly undermines the PPSA attempt to fully integrate the order of priority with the order of registration.

A PPSA also establishes a host of special priority rules for which there is no counterpart in the federal *Bank Act*. All PPSA versions, for instance, subordinate a security interest in after-acquired collateral to any subsequent purchase money security interests. But under the *Bank Act*, a section 178 interest automatically extends to all the debtor's after-acquired assets with no express protection for subsequent PMSI's. If the subsequent PMSI is drafted in the form of a conventional conditional sale, it may be that it will take priority even under federal law on the theory that the vendor's reservation of title prevents the section 178 interest from ever attaching. Otherwise, the PMSI superpriority is not recognized in the *Bank Act* priority regime.

Ultimately, of course, the lack of compatibility between the PPSA and section 178 priority regimes can only be resolved by revising the *Bank Act* security provisions. The attempt in section 4(k) of the Western Model to deny banks taking section 178 security the benefit of the PPSA registry is therefore just a bargaining tool designed to force the federal government to the table to discuss what form harmonization should take and indeed, whether it still makes any sense to have section 178 security at all.

The 1991 Federal Position Paper on Revising Bank Act Security:

The federal Department of Finance recently retained a Toronto law firm, Osler, Hoskin and Harcourt, to prepare a position paper on revising the security provisions of the *Bank Act* so as to achieve greater compatibility with provincial personal property security law, and especially provincial PPSA legislation. That position paper was completed in January 1991 and was a significant agenda item at the recent meeting of the Canadian Conference on Personal Property Security Law. While the federal representatives at the meeting were careful to emphasize that the position paper in no way represented official federal policy at this stage, they did stress that the Department remains firmly committed to maintaining a federal legislative presence in relation to the taking of security by the chartered banks.

The 1991 position paper commissioned by the Department of Finance basically advocates replacing the existing security provisions of the *Bank Act* with a rather idiosyncratic federal version of a Personal Property Security Act for banks complete with a national registry. The result would radically expand the scope of *Bank Act* security. In particular:

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[20] The Saskatchewan Court of Appeal adopted this approach to resolve priority between a section 178 security interest and a PPSA interest on after-acquired property in *Pulsar Ventures Inc.; Bank of Montreal v. Pulsar Ventures Inc.* (1985) 5 PPSAC 113

- at present, section 178 security may be given only by specified classes of business debtors. The position paper advocates allowing the banks to take *Bank Act* security from "any person", including, *inter alia*, consumer debtors and indeed certain entities which have not hitherto been considered to be legal persons at all such as partnerships and other unincorporated associations.
- at present, section 178 security may be taken only against tangible goods and other hard products. The position paper advocates allowing the banks to take *Bank Act* security in all forms of personal and movable property, both tangible and intangible.

Moreover, the position paper advocates making the new federal regime mandatory for all chartered banks, barring them from taking security under provincial personal property security law. The net effect of the proposal would be to thus create two comprehensive but entirely separate personal property security regimes in Canada: a federal one for the chartered banks and a provincial one for credit unions and other financiers.

Responses to the Position Paper:

The provincial responses to the Position Paper to date all welcomed the commissioning of the paper by the federal Finance Department as an important symbolic step towards opening a federal-provincial dialogue on the harmonization issues raised by the advent of new personal property security legislation at the provincial level.

But as a specific reform proposal, the position paper met with no support. It is not just that the complete removal of the chartered banks from the clientele base of the provincial registry systems would have obvious and drastic fiscal repercussions on their operation. Quite apart from such pragmatic considerations, there are serious policy and philosophical objections to the approach advocated in the position paper:

- The authors of the position paper freely admit that immunizing the banks from regulatory restrictions imposed by provincial legislation on secured lending practices is one of the reasons they advocate the creation of a comprehensive national personal property security law for banks. The authors, in other words, extol the virtues of maintaining a privileged position for banks in the secured lending world, an approach which seem singularly out of step with contemporary efforts to "create a level playing field" for all players in the financial services market;
- Moreover, there is significant disharmony between the personal property security law for banks proposed in the position paper and provincial PPSA legislation. This is because the proposed federal version is based primarily on the Ontario PPSA. But the Ontario PPSA is itself out of step with the Model PPSA developed by the Canadian Conference on Personal Property Security Law and either already in place or proposed for enactment in other Canadian jurisdictions. Were the Ontario PPSA thus adapted for national application to banks, the efforts of other Canadian jurisdictions to improve and harmonize their personal property security legislation would be undermined and the gap between the laws governing banks and other financiers further widened.
- The personal property security law for banks proposed in the position paper also contains a number of idiosyncratic features not found in any Canadian PPSA including Ontario's which are of highly questionable technical, substantive and policy merit.
- The creation of separate comprehensive federal and provincial registry systems for personal property security interests introduces an unnecessary level of expense, duplicity and complexity in an area where the modern trend is

towards integration and simplicity.

Future Directions:

The representatives of Finance Canada who attended the Conference on Canadian Personal Property Security Law freely acknowledged that the federal government does not intend to revise the parts of the *Bank Act* dealing with security interests in the immediate future. However, if and when reform does take place, it is unlikely to be along the lines advocated by the position paper. There are simply too many political and policy objections to the creation of a separate but unequal federal secured lending law for banks.

As to what other direction future reform might take, some provinces have suggested that a better solution would be to simply repeal the sections of the *Bank Act* dealing with security in their application to provinces which have enacted a Personal Property Security Act (or its equivalent in the case of Quebec). This solution would ensure that the chartered banks had access to a modern comprehensive personal property security regime while equalizing the legal position of banks and other secured lending institutions.

In any event, the best interim step for New Brunswick would be to join with British Columbia and Alberta in supporting the suggestion by Professor Ronald Cuming, chief architect of the Western Model PPSA, that a formal working group composed of federal and provincial representatives be struck to examine the proposals contained in the position paper and to explore more palatable solutions.

In the meantime, the recent federal initiative further demonstrates the timeliness of New Brunswick's decision to implement a PPSA system since one of the rationales urged by the federal government for maintaining a legislative presence in the field of bank security is that the banks are still forced to operate within an archaic and inefficient personal property security regime in those provinces that have not yet enacted a PPSA.

(k) Mortgages under the Canada Shipping Act[21]

While vessels are chattels, their use in interprovincial and international navigation and shipping makes their transfer - whether by sale or security - more properly the subject of federal rather than provincial regulation. In recognition of this, the *Canada Shipping Act* establishes a registration, priorities and enforcement regime applicable to the transfer and mortgage of ships.

The paramountcy of federal law on marine security is reflected in the existing New Brunswick *Bills of Sale Act* which expressly exempts "a ship or vessel registered under the *Canada Shipping Act...*" from the definition of "chattels", the mortgage of which would otherwise be subject to registration under the Act.

Unlike the Ontario PPSA[22], section 4(k)(ii) of the Western Model PPSA maintains the existing constitutionally-dictated policy and expressly excludes ships' mortgages under the *CSA* from the scope of the Act.

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[21] On the Canadian law of marine security in general, and the interrelationship of federal and provincial law in this area in particular, see generally J.D. Buchan, *Mortgages of Ships*, Butterworths (Toronto and Vancouver, 1986)

[22] Neither the old nor the new Ontario PPSA contains an equivalent exclusion even though the pre-PPSA Ontario *Bills of Sale and Chattel Mortgages Act* expressly exempted "mortgages of vessels registered under any Act in that behalf". It is clear that for constitutional reasons, the Ontario Act nonetheless cannot apply to ships' mortgages registered under the *CSA*; however, its applicability to unregistered mortgages is unsettled: see *Re Doucet*

The PPSA exclusion also cures one ambiguity in the existing law. The *BSA* exclusion is worded so as to apparently exempt *all* mortgages of registered ships or vessels from registration thereunder, *i.e.*, even mortgages that have not been registered under the *CSA* nor executed in a form appropriate to be registered thereunder. While failure to register will prevent the mortgagee from taking advantage of the *CSA* priority and power of sale provisions, the unregistered mortgage will still be valid and enforceable by the mortgagee against the mortgagor's execution creditors and trustee in bankruptcy[23]. Insofar as the PPSA limits the exemption to "a mortgage under the *Shipping (Canada) Act*" (*i.e.*, as opposed to a mortgage on "a ship or vessel registered under the *Canada Shipping Act*), it is at least arguable that a secured party who chooses not to register marine security taken on a registered vessel under the *CSA* will have to register under the PPSA if it wishes to maintain its rights in the collateral against the debtor's execution creditors or trustee in bankruptcy[24].

Finally, it must be noted that not all vessels are subject to registration or recording under the *CSA*. Pleasure craft and other smaller vessels are instead regulated by the licensing regime established under the *Small Vessels Regulations* made pursuant to the *CSA*[25]. Unlike the *CSA* regime governing registered and recorded vessels, the records maintained on licensed vessels are not open to public searches and do not record encumbrances against the vessels[26]. Accordingly, a secured party who takes a security interest in a licensed vessel will be subject to the PPSA as it presently is to the *BSA*[27].

(continued)
(1984) 150 DLR 3d 53 (Ont SC)

[23] Footnote 21, at p. 41.

[24] *Ibid*. In *Re Doucet* (1984) 150 DLR (3d) 53 (Ont SC), it was unnecessary to decide the issue because the secured party had registered a financing statement on the relevant vessel under the PPSA in any event, thereby precluding any claim by the trustee in bankruptcy.

[25] *Ibid*, at p. 23

[26] *Ibid*

[27] *Ibid*, at pp. 49-50

SECTION 5

CONFLICT OF LAWS: GOODS AND DOCUMENTARY COLLATERAL IN THE POSSESSION OF THE SECURED PARTY

5(1) Subject to this Act, the validity, perfection and effect of perfection or non-perfection of

(a) a security interest in goods, or

(b) a possessory security interest in a security, an instrument, a negotiable document of title, money and chattel paper,

is governed by the law of the jurisdiction where the collateral is situated when the security interest attaches.

5(2) For the purposes of subsection (1), an uncertificated security is situated where the records of the clearing corporation are kept.

5(3) A security interest in goods perfected under the law of the jurisdiction in which the goods are situated at the time the security interest attaches but before the goods are brought into the Province continues perfected in the Province if it is perfected in the Province,

(a) not later than 60 days after the goods are brought into the Province,

(b) not later that 15 days after the day the secured party has knowledge that the goods have been brought into the Province, or

(c) before perfection ceases under the law of the jurisdiction in which the goods were situated when the security interest attached,

whichever is earliest, but the security interest is subordinate to the interest of a buyer or lessee of the goods who acquires the interest without knowledge of the security interest and before it is perfected in the Province under section 24 or 25.

5(4) A security interest that is not perfected as provided in subsection (3) may be otherwise perfected in the Province under this Act.

5(5) Where a security interest referred to in subsection (1) is not perfected under the law of the jurisdiction in which the collateral was situated at the time the security interest attached and before the collateral was brought into the Province, it may be perfected under this Act.

COMMENTARY

Purpose of Sections 5 to 8

Financing activity within the Canadian economy does not always subdivide neatly according to our political-legal jurisdictional boundaries. Multijurisdictional contacts may be present at the time security is taken as where the debtor and the collateral are located in different jurisdictions or where the collateral is of a kind that is used in more than one jurisdiction. Here the choice of law dilemma faced by the secured party is to determine whose laws it should adhere to ensure a valid perfected security interest in the collateral. Multijurisdictional contacts may also arise as a result of a subsequent turn of events as where either the collateral or the debtor or both are removed from another jurisdiction into the province. Here the choice of law dilemma faced by the secured party is to determine what if anything it must do to ensure that its security interest remains effective in the new locus.

Sections 5 to 8 of the PPSA are intended to provide guidance on the choice of law complications that are presented when a financing transaction has contacts to more than one jurisdiction either at the outset or because of a subsequent removal of the collateral or the debtor or both into the province. Section 8 also addresses the procedural and substantive issues affecting the enforcement of the security interest.

Choice of Law for Goods and Documentary Collateral in the Secured party's Possession

In relation to goods and possessory documentary collateral, the situs of the collateral is the most appropriate connecting factor for choice of law purposes since third parties dealing with collateral that can be reduced into possession are apt to deal with it *in situ*. Accordingly, PPSA section 5(1) provides that the validity, perfection and effect of perfection or non-perfection of a security interest in goods collateral is governed by the law of the jurisdiction where the collateral is located when the security interest attaches. However, if goods subject to a security interest that was perfected abroad are later moved into the Province, section 5(2) provides that the out-of-province secured party must register or otherwise perfect if it wishes to retain its perfected status in the new location. While the existing registration statutes impose a similar requirement, the re-registration obligation does not arise until the secured party learns of the transfer after which it has a thirty day grace period for registration. This approach leads to litigation on the question of whether and when the secured party had knowledge of the transfer and gives an unduly lengthy period of protection to the secured party who fails to monitor the location of the collateral to the prejudice of third parties at the new situs. The PPSA achieves a better balancing of the rights of the secured party and third parties by stipulating an outside time limit for reperfection regardless of whether the secured [arty has become aware of the transfer when the period expires. Under section 5(2), reperfection must take place within the earliest of the following time periods:

(1) 60 days after the goods are brought into the province;
(2) 15 days after the secured party has knowledge that the goods have been brought into the Province[1];
(3) prior to the date perfection lapses at the original situs

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[1] As to the meaning of "knowledge", see section 1(2).

Conditional or Absolute Protection?

The existence of a period of temporary perfection at the new situs raises the issue of whether the secured party's perfected status is absolute during the time period or conditional on reperfection prior to expiry. The literal wording of the equivalent provisions in the old Ontario PPSA suggested that the secured party would enjoy the benefits of perfected status during the temporary perfection period regardless of whether or not it reperfected prior to the expiry of that period. On this approach, third parties who dealt with the collateral at the new situs during the temporary perfection period would be subordinated to the security interest and would not be entitled to take advantage of the subsequent lapse in perfected status. While there was some American jurisprudence supporting this result, it was roundly rejected in the Ontario PPSA jurisprudence. That the temporary perfection period afforded by section 5(1) is conditional on perfection before the expiry of the relevant period is made clear in both the Western Model PPSA and the new Ontario PPSA as well as in the Saskatchewan PPSA.

Protection of Intervening Transferees of the Collateral

Should the secured party succeed in reperfecting within the relevant time period, its perfected status will be effective, even as against interests arising prior to when the reperfecting step was taken with one exception. The one exception is where the intervening interest is a buyer or lessee of the collateral for value without knowledge. While this approach renders a secured party vulnerable to misconduct by an absconding debtor, the professional lender is presumed to be in a better position to absorb the risk than the good faith transferee[2].

While the new Ontario Act likewise protects intervening purchasers and lessees, it does so only where the goods are acquired as "consumer goods". This is an unfortunate restriction. After all, if the secured party is to enjoy the benefits of temporarily perfected status in the absence of either registration or possession, it should at least be prepared to accept the risk of subordination to that class of third party transferees who are most vulnerable: good faith buyers. There is no reason in this regard to distinguish between consumer and professional buyers since the policy of requiring the secured party to perform an act of public notice applies to both.

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[2] Ziegel and Cuming, "The Modernization of Canadian Personal Property Security Law" (1981) 31 U of T Law J 249 at 258.

NOTES

SECTION 6

CONFLICT OF LAWS GOODS TO BE REMOVED FROM THE JURISDICTION

6(1) **Subject to section 7,**

(a) **if the parties to a security agreement that creates a security interest in goods in one jurisdiction understand at the time the security interest attaches that the goods will be kept in another jurisdiction, and**

(b) **if the goods are removed to the other jurisdiction, for purposes other than transportation through the other jurisdiction, not later than 30 days after the security interest attaches,**

the validity, perfection and effect of perfection or non-perfection of the security interest is determined by the law of the other jurisdiction.

6(2) **If the jurisdiction referred to in subsection (1) is not the Province and the goods are later brought in to the Province, the security interest in the goods is deemed to be a security interest to which subsection 5(3) applies if it was perfected under the law of the jurisdiction to which the goods were removed.**

COMMENTARY

The situs of the goods at the point of attachment of a security interest is an appropriate connecting factor for determining what law will apply to the validity and perfection of that security interest where it is intended that the goods remain at the situs of attachment for the foreseeable future. But goods are often purchased or otherwise financed on secured credit terms in one jurisdiction with the intention that they be immediately transported back to the buyer's residence or place of business in another jurisdiction. In such cases, it should be unnecessary for the secured party to have to conform to the validity and perfection laws of the jurisdiction where the security interest attaches since it will have to almost immediately make a second registration in the jurisdiction to which the goods are intended to be removed. Section 6(1) provides for this kind of case. So long as the parties understand that the goods are to be kept in another jurisdiction when the security interest attaches *and* the goods are in fact removed to that other jurisdiction within thirty days after the security interest attaches, the validity and perfection of the security interest is governed by the law of the jurisdiction to which the goods are removed rather than the jurisdiction where the security interest attached.

Section 6(2) is meant to ensure that the secured party will be obliged to reperfect pursuant to section 5 should goods subject to a security interest that attached in the Province but were removed to another province as contemplated by section 6(1) later be brought back into the Province.

NOTES

SECTION 7

CONFLICT OF LAWS
MOBILE GOODS, INTANGIBLES, EXTRACTED MINERALS AND NON-POSSESSORY SECURITY INTERESTS IN DOCUMENTARY COLLATERAL

7(1) For the purposes of this section, a debtor is located

(a) at the place of business of the debtor, if any,

(b) at the executive office of the debtor, if the debtor has more than one place of business, and

(c) at the principal residence of the debtor, if the debtor has no place of business.

7(2) The validity, perfection and effect of perfection or non-perfection of

(a) a security interest in

(i) an intangible, or

(ii) goods that are of a kind that are normally used in more than one jurisdiction, if the goods are equipment or are inventory leased or held for lease by the debtor to others, and

(b) a non-possessory security interest in chattel paper, a security, a negotiable document of title, an instrument or money,

is governed by the law, including the conflict of law rules, of the jurisdiction where the debtor is located when the security interest attaches.

7(3) If the debtor relocates to another jurisdiction or transfers an interest in the collateral to a person located in another jurisdiction, a security interest perfected in accordance with the applicable law as provided in subsection (2) continues perfected in the Province if it is perfected in the other jurisdiction

(a) not later than 60 days after the day the debtor relocates or transfers an interest in the collateral to a person located in the other jurisdiction,

(b) not later than 15 days after the day the secured party has knowledge that the debtor has relocated or transferred an interest in the collateral to a person located in the other jurisdiction, or

(c) prior to the day that perfection ceases under the law of the first jurisdiction,

whichever is earliest.

7(4) **If the law governing the perfection of a security interest referred to in subsection (2) or (3) does not provide for public registration or recording of such security interest or a notice relating to it, and the collateral is not in the possession of the secured party, the security interest is subordinate to**

(a) an interest in an account payable in the Province,

(b) an interest in goods, a security, an instrument, a negotiable document of title, money or chattel paper acquired when the collateral was situated in the Province,

unless it is perfected under this Act before the interest referred to in paragraph (a) or (b) arises.

7(5) **A security interest referred to in subsection (4) may be perfected under this Act.**

7(6) **Notwithstanding section 6 and subsection (2) of this section, the validity, perfection and effect of perfection or non-perfection of a security interest in minerals or in an account resulting from the sale of the minerals at the minehead**

(a) that is provided for in a security agreement executed before the minerals are extracted, and

(b) that attaches to the minerals upon extraction or attaches to an account upon sale of the minerals,

is governed by the law of the jurisdiction in which the wellhead or minehead is located.

7(7) **For the purposes of subsection (6), "minerals" includes petroleum and gas and "minehead" includes "wellhead".**

COMMENTARY

The location of the collateral is clearly an inappropriate connecting factor where the collateral is of a type that is incapable of being reduced into physical possession. This is true of intangibles. This is also true of money and documentary collateral which has not been taken into possession by the secured party. For this reason, section 7(2) substitutes the law of the jurisdiction where the debtor is located when the security interest attaches as the relevant connecting factor for choice of law on the validity and perfection of security interests in these forms of collateral.

Under section 7(2), the debtor's location is also used as the connecting factor for so-called mobile goods: i.e., goods that are of a type that are normally used in more than one jurisdiction, if the goods are equipment or are inventory leased or held for lease by the debtor to others. The rationale for rejecting the situs of the collateral as the appropriate connecting factor for these forms of collateral is not that the collateral cannot be reduced into possession. Obviously, it can. However, it would be unfairly burdensome to require a secured party in a financing arrangement involving mobile goods to have to register in every jurisdiction to which the goods may conceivably be removed from time to time. It is also unnecessary since third parties would logically be more apt to search the registry in the debtor's home province for outstanding interests in any event. Accordingly, section 7(2) substitutes the debtor's location as the appropriate connecting factor in relation to mobile goods of the kind described above.

Guidance on how the debtor's location is to be determined for the purposes of section 7 is provided in section 7(1).

In the event the debtor changes location subsequent to the attachment of the security interest or transfers an interest in the collateral to a person located in another jurisdiction, the secured party must reperfect its interest there within the time periods prescribed in section 7(3). The time periods parallel those specified for reperfection under section 5 in the event goods are relocated to another venue after initial attachment.

Section 7(4) takes account of the fact that the kind of collateral dealt with in section 7 may not be subject to any public registration requirements in non-PPSA jurisdictions. If that is the case, third parties dealing with the collateral in-province will have no means of verifying the existence of the security interest by searching the registry systems in the debtor's home province. Where the applicable law under section 7(1) or (2) is such a jurisdiction, section 7(4) provides that the security interest will be subordinated to interests taken in the collateral unless it is registered in the province.

Until extraction, minerals constitute part of the realty. Section 7(6) takes account of this and provides that the validity and perfection of a security interest taken in extracted minerals before their actual extraction is governed by the law of the situs of the relevant mine.

NOTES

SECTION 8

CONFLICT OF LAWS SUBSTANCE AND PROCEDURE

8(1) **Notwithstanding sections 5, 6, and 7,**

(a) procedural issues involved in the enforcement of the rights of a secured party against collateral other than intangibles are governed by the law of the jurisdiction in which the collateral is located when the rights are exercised,

(b) procedural issues involved in the enforcement of the rights of a secured party against intangibles are governed by the law of the forum, and

(c) substantive issues involved in the enforcement of the rights of a secured party against collateral are governed by the proper law of the contract between the secured party and the debtor.

8(2) **For the proposes of sections 5, 6, and 7, a security interest is perfected under the law of a jurisdiction when the secured party has complied with the law of the jurisdiction with respect to the creation and continuance of a security interest and the security interest has a status in relation to the interests of other secured parties, buyers and creditors and a trustee in bankruptcy of the debtor similar to that of an equivalent security interest created and perfected under this Act.**

COMMENTARY

Under general conflict of laws principles, only substantive issues are governed by the relevant *lex causae*. In order to ensure convenience in the administration of justice, procedural issues are governed by forum law. Section 8(1) provides guidance on the classification of laws as substantive or procedural in relation to the enforcement of security interests in collateral and in general codifies common law views.

Section 8(2) takes account of the fact that the term "perfection" may not be a term of art in non-PPSA jurisdictions and provides that a security interest will be considered perfected for the purposes of sections 5 to 7 when it achieves a status in relation to third party claims equivalent to that enjoyed by a perfected security interest under the PPSA.

NOTES

PART 2

VALIDITY OF SECURITY AGREEMENT AND RIGHTS OF PARTIES

SECTION 9

FREEDOM OF CONTRACT

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9. Subject to this or any other act, a security agreement is effective according to its terms.

COMMENTARY

While section 9 confirms that the principle of freedom of contract applies to security agreements, a secured party who wishes to gain an effective security interest in collateral cannot simply rely on the terms of its agreement with the debtor[1]. A contract entered into between two parties cannot ensure the effectiveness and priority status of an interest in property as against third parties. The perfection and priority rules of the PPSA are paramount. Indeed, the terms of the contract may not even be binding *inter partes*. The rights and obligations established by Part 5 are generally not subject to waiver, a reflection of the longstanding supervisory jurisdiction over the default enforcement process. Section 9 accordingly makes the effectiveness of any security agreement "subject to this or any other act".

Within the limitations imposed by the PPSA and any other relevant law, however, section 9 does make it clear that the parties are free to draft their agreement in the terms best suited to fulfill their individual intent and circumstances.

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[1] See, for instance, the remarks of Arnup J in *Rogerson Lumber Co v. Four Seasons Chalet* (1980) 113 DLR 3d 671 (Ont CA) at 676.

NOTES

SECTION 10

EVIDENTIARY REQUIREMENTS FOR ENFORCEABILITY OF SECURITY AGREEMENTS AGAINST THIRD PARTIES

10(1) Subject to subsection (2), a security agreement is enforceable against a third party only where

(a) the collateral is in the possession of the secured party, or

(b) the debtor has signed a security agreement that contains

(i) a description of the collateral by item or kind,

(ii) a statement that a security interest is taken in all of the debtor's present and after-acquired property, or

(iii) a statement that a security interest is taken in all of the debtor's present and after-acquired property except specified items or kinds of personal property.

10(2) For the purposes of subsection (1)(a), a secured party is deemed not to have taken possession of collateral that is in the apparent possession or control of the debtor or the debtor's agent.

10(3) A description is inadequate for the purposes of subsection (1)(b) if it describes the collateral as consumer goods or equipment without further reference to the item or kind of collateral.

10(4) A description of collateral as inventory is adequate for the purposes of clause (1)(b) only while it is held by the debtor as inventory.

10(5) A security interest in proceeds is enforceable against a third party whether or not the security agreement contains a description of the proceeds.

COMMENTARY

Background and Purpose of Writing Requirement

At common law, agreements that create a security interest in personal property are not subject to any writing or other formal or evidentiary requirements in order for the interest to attach and become enforceable[1]. For the purposes of enforceability against third parties, however, the common law rule has long since been altered by legislation. Under the existing registration statutes, a security interest will be void as against creditors and subsequent purchasers and mortgagees unless the security agreement is evidenced by a written agreement registered in the appropriate registry.

The PPSA replaces the existing documentary filing registry systems with a notice filing system. That is to say, only notice of the security interest (in the form of a one-page "financing statement"), not the security agreement itself, need be registered in the PPSA registry. This change does not mean that security interests under the PPSA will no longer be subject to any writing requirements. It simply means that the writing requirements for security agreement must be stated independently of the registration requirements under the PPSA. This is the function of section 10(1) of the Act under which a security agreement is not enforceable against third parties unless the debtor has signed a security agreement that meets certain minimal content requirements. Section 18 of the Act provides a procedure whereby third parties with a legitimate interest can obtain a copy of the security agreement and information on the details of the financing arrangement from the secured party.

The evidentiary requirements set out in section 10(1) will allow the parties far greater freedom and flexibility in arriving at a security agreement that reflects their particular circumstances than is the case presently. The existing registration statutes impose technical and prolix requirements regarding the form and content of the security documentation that must be registered. Section 10 reduces the writing and content requirements for security agreements to the minimal necessary for evidentiary purposes. Apart from the debtor's signature, the only content requirement mandated by section 10 is in relation to the adequacy of description of the collateral. Otherwise, the parties are now free to express their agreement in whatever terms they wish and no longer need be concerned with executing additional affidavits except as they may wish for their own purposes.

Possession as a Substitute for Writing

The *Bills of Sale Act* currently dispenses with any writing and registration requirements if the secured party takes and retains possession of the collateral. Thus a possessory security interest in chattels is enforceable against third parties even if the security agreement is entirely oral.

PPSA section 10(1)(a) likewise dispenses with any writing or other evidentiary requirements if the collateral is in the possession of the secured party. The reason is obvious. Possession by the secured party is adequate evidence to third parties both of the debtor's consent to the security interest and of what collateral it covers.

Under the existing law, only an actual and not merely a constructive change of possession of the collateral is regarded as a sufficient evidentiary substitute for written evidence of the contract. Thus, a pledgor's retention of possession under a contract making her custody the custody of the pledgee suffices only to complete the pledge as between the parties. As against third parties, the *Bills of Sale Act* requires an "actual and continued change of possession" sufficient to afford public evidence of the security interest.

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[1] See, *e.g.*, *Bonin v. Robertson* (1893) 2 Terr LR 21 (NWT CA)

This same basic policy is carried over to the PPSA. Under section 10(3), a secured party is deemed not to have taken possession of collateral that is in the apparent possession or control of the debtor or the debtor's agent. In such a case, a signed security agreement remains necessary.

Description of Collateral in Security Agreement

Existing law requires that collateral be sufficiently described in the security agreement to enable it to be identified. This requirement is meant to ensure that third parties dealing with the debtor are able to ascertain which assets in the debtor's possession are caught by the security interest. It also serves the interest of minimizing later disputes on what collateral is subject to the security interest and relieves secured parties from the temptation to later claim greater collateral than the original agreement provided for.

In addressing this same concern, the PPSA authorizes three alternative methods of description.

(i) description by item or kind. Under section 10(1)(b)(i), collateral may firstly be described by item or kind. Description by item is appropriate where the collateral consists of a specific something capable of being identified as separate and distinct from all other items including those within the same generic category - for instance, a specific chattel that may be identified by name, serial number, model, colour and manufacturer or a specific account receivable owing the debtor from a specified account debtor under a specified contract. Description by kind is appropriate where the collateral consists of all items within the same generic category - for instance, "all accounts now or hereinafter due or owing the debtor" or "all chattels now or hereinafter acquired by the debtor". More limited generic categories - "all widgets supplied to the debtor by Acme Co" or "all widgets located at the Fredericton offices of Debtor Co." - may also of course be used if this is the intent.

(ii) statement that a security interest is taken in all of the debtor's present and after-acquired personal property. It is not uncommon for a secured party who is providing general ongoing financing to a commercial debtor to want to take a complementary general security interest in all of the debtor's present and future assets. If this is indeed the intent, there is no reason why the various assets should have to be individually described either by specific item or generic kind. To the question - which of the debtor's assets are caught by the security interest? - a simple statement that a security interest is taken in all of the debtor's present and after-acquired property gives a clear answer - everything. Accordingly, section 10(1)(b) makes it clear that this type of statement constitutes an adequate description of the collateral. This liberality reflects the main thrust of the jurisprudence under the existing law.

(c) statement that a security interest is taken in all of the debtor's present and after-acquired property except specified items of kinds of personal property. Occasionally, a secured party may wish to take a general security interest in all of the debtor's present and future assets but except out certain items of kinds. It may be, for instance, that the debtor has already granted a security interest in certain items or kinds of personal property and it is in the interests of all concerned that the prior secured party's collateral be clearly excepted from the security interest. Rather than requiring the parties to revert to an item or kind description, section 10(1)(b) authorizes the use of a statement that a security interest is taken in all of the debtor's present and after-acquired property except specified items or kinds. Provided that the relevant assets are adequately described by item or kind, this formulation likewise adequately ensures that third parties are able to ascertain the extent of the collateral.

Description of Goods Collateral - "Consumer Goods", "Equipment" and "Inventory"

For various purposes, the PPSA divides all goods into the three mutually exclusive categories of "consumer goods", "inventory" and "equipment": see section 1. These categories are intended to refer to the debtor's primary use of the collateral at a particular time rather than to identify the type or kind of goods collateral involved. "Consumer goods", for instance, are defined as goods used or acquired for use by the debtor primarily for personal, family or household purposes and may in a particular case include anything from a sewing machine to a bag of cement. Accordingly, section 10(4) provides that a description is inadequate for the purposes of section 10(1)(a) if it describes the goods as consumer goods or equipment without further reference to the kind of collateral[2].

Section 10(5), however, expressly authorizes the description of collateral as "inventory". Notwithstanding that "inventory" is also a use description rather than a kind description, it is a generally accepted method of describing collateral in existing commercial practice. This is because, in contrast to "consumer goods" and "equipment", it is relatively easy for third parties to discern which goods in a debtor's possession are being held as inventory. Accordingly, the evidentiary objectives of section 10 are satisfied by this particular form of use description. This will no longer be so of course should the debtor remove an item from inventory and convert it to a personal or capital use. For this reason, section 10(4) makes it clear that "inventory" is an adequate description only while it is held by the debtor as inventory.

No Need to Describe Proceeds in Security Agreement

Section 10(5) of the Act makes it clear that a security agreement is not rendered unenforceable against third parties simply because the security agreement does not contain a description of the proceeds. This is because a security interest in collateral automatically extends to the proceeds of any dealing with the collateral under section 28(1). Accordingly, there is no need to make this explicit in the security agreement. As to the description requirements that apply to proceeds for the purposes of perfection, see the commentary on section 28.

Comparison with UCC and Ontario PPSA

The PPSA writing requirement for security agreements is frequently described as being in the nature of a Statute of Frauds provision. In view of the criticisms that have been leveled against the Statute of Frauds policy over the centuries, its maintenance in a modern commercial statute may seem strange. But there are in fact two sorts of Statute of Frauds provisions. The first type requires a written memorandum of the contract for the purposes of *inter partes* enforceability. It is this type that has earned universal condemnation and which found its way into UCC article 9-203 under which the secured party's failure to satisfy the writing requirement makes its security interest unenforceable even against the debtor unless she takes possession of the collateral. The new Ontario PPSA apparently adopts this approach as well. In contrast, the evidentiary requirements stated in section 10 of the Western

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[2] Section 10(4) thus reverses *Touche Ross Ltd. v. The Royal Bank of Canada* [1984] 3 WWR 259 where the Saskatchewan Court of Appeal accepted "equipment" as a sufficient collateral description for the purposes of the regulations on collateral descriptions in financing statements and *a fortiori* for the purposes of the section 10 requirements on collateral descriptions in security agreements.

PPSA model apply only to enforceability against third parties. As against the debtor, it is clear that a nonpossessory oral security interest will be enforceable. This is the preferred policy for two reasons. Firstly, it is consistent with the existing law (see the discussion above). Secondly, it comports with the historical original justification for a writing requirement as it pertains to the enforceability of the interest against the debtor's execution creditors: the need for some concrete objective evidence of the time the security interest came into existence. Otherwise, too much latitude exists for creditors threatened with a competing third party claim to suddenly invent an oral security interest of greater magnitude than that bargained for. The prevention of fraudulent preferences (or at least their discouragement, since it is always possible to create security documentation after the fact) is the basic *raison d'etre* for the section 10 writing requirement.

Proposed Revisions to Section 10 of the Western Model

The Legislative Review Committee of the Canadian Conference on Personal Property Security Law will be asked to consider the following revisions to section 10 of the Western Model PPSA which, if approved, would form part of the New Brunswick PPSA :

(i) Revise section 10(1)(a) to add the following italicized words:

10(1) Subject to subsection (2), a security interest is only enforceable against a third party where

(a) the collateral is in the possession of the secured party *pursuant to a security agreement*

The purpose of the proposed revision is to make it explicit that the secured party must be in possession of the collateral pursuant to a security agreement rather than for some other purpose in order to constitute possession for the purposes of section 10.

(ii) Revise section 10 to include a new section 10(2) as follows with the remaining subsections renumbered accordingly:

10(2) *For the purposes of subsection (1)(a), a secured party has possession of collateral only while it is actually held as collateral and not while it is held as a result of a seizure or repossession.*

As presently drafted, section 10 does not clarify whether or not taking possession of the collateral for the purposes of realization constitutes possession for the purposes of section 10(1)(a). Certainly, it does not for the purposes of perfection under section 24 and it seems that the failure to specify the same rule for the purposes of section 10 was entirely inadvertent. The proposed revision will make it clear that an oral non possessory agreement for security cannot later be made enforceable against third parties merely because the secured party subsequently takes possession for the purposes of realization on default. A similar rule obtains under the existing law and is consistent with the objective of section 10: *viz.*, that the security interest be concretely evidenced during the currency of the financing arrangement. For a full discussion, see the commentary on section 24.

NOTES

SECTION 11

DEBTOR'S RIGHT TO COPY OF WRITTEN SECURITY AGREEMENT

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11 **Where a security agreement is in writing, the secured party shall deliver a copy of the security agreement to the debtor not later than 10 days after it is executed and, if the secured party fails to do so after a request by the debtor, a Court may, on application by the debtor, order the delivery of the copy to the debtor.**

COMMENTARY

Secured Party's Delivery Obligation

Security agreements are usually drafted by the secured party in standard form. More often than not, the debtor's only input, especially in the consumer context, is her signature. Yet at present, only conditional sellers are subject to an express statutory duty to give their debtors a copy of the agreement within a set time period after its execution[1].

PPSA section 11 imposes a statutory obligation on *all* secured parties to deliver a copy of the security agreement to the debtor within 10 days of its execution. The delivery obligation applies in all cases where the parties have in fact reduced their agreement to writing; that is to say, regardless of whether or not the security interest is one which, under section 10, must be evidenced by a writing.

Consequences of Non-compliance

Like the existing *Conditional Sales Act* provision, section 11 of the PPSA empowers the debtor to apply to Court for a compliance order where, after request, the secured party fails to meet its delivery duty.

Otherwise, the jurisprudence on the equivalent issue under the *Conditional Sales Act* indicates that non compliance does not invalidate the agreement in any way provided that it is not prejudicial as where the debtor is aware of the terms[2]. The same position would probably be taken under the PPSA. While section 66 gives a cause of action to any person for nonperformance of an obligation owed to them under the PPSA, the plaintiff is only entitled to recover if the failure to perform the obligation caused reasonably forseeable loss and non compliance with section 11 is not one of the situations for which deemed damages are prescribed.

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[1] Section 11 of the *Conditional Sales Act* requires a conditional seller to deliver a copy of the conditional sale to the buyer within twenty days of its execution.

[2] *CIBC v. Bedard* (1985) 63 NBR (2d) 223 (NBQB)

If consumer debt is involved, however, the secured party should keep in mind the *Cost of Credit Disclosure Act*[3] which requires a creditor to furnish to the debtor, before credit is extended, a statement in writing which sets out the cost of borrowing. Non-compliance with that *Act* will disentitle the creditor from claiming interest even where the debtor is not prejudiced by the non disclosure[4].

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[3] RSNB 1973 c. C-28, section 15

[4] *CIBC v. Bedard* (1985) 63 NBR (2d) 223 (NBQB)

SECTION 12

WHEN ATTACHMENT OCCURS

12(1) **A security interest attaches when**

(a) value is given,

(b) the debtor has rights in the collateral, and

(c) except for the purpose of enforcing rights as between the parties to the security agreement, the security interest becomes enforceable within the meaning of section 10,

unless the parties have specifically agreed to postpone the time of attachment in which case the security interest will attach at the time specified in the agreement.

12(2) **For the purposes of subsection (1)(b) and without limiting other rights, if any, which the debtor has, a lessee under a lease for a term of more than one year or a consignee under a commercial consignment has rights in the goods when the lessee or consignee obtains possession pursuant to the lease or consignment.**

12(3) **For the purposes of subsection (1), a debtor has no rights in**

(a) crops until they become growing crops,

(b) the young of animals until they are conceived,

(c) petroleum, gas or minerals until they are extracted, or

(d) trees, other than crops, until they are severed.

COMMENTARY

The Concept of Attachment

By definition, a security interest does not exist *in vacuo* but "attaches" to an asset. The concept of "attachment" in personal property security law is thus synonymous with the creation of a security interest. Unless and until attachment occurs, no security interest exists and the secured party will be unable to exercise the default enforcement remedies set out in Part 5 of the Act against the collateral. The question of whether and when attachment occurs may also be significant under the PPSA priority and conflict of laws rules.

Section 12 distinguishes between attachment *inter partes* and attachment as against third parties. In order for attachment to occur as between the debtor and secured party, the secured party must give value and the debtor must have rights in the collateral. But for the security interest to attach as against third parties, section 12 imposes a third requirement.

The security interest must become enforceable under section 10 of the Act: *viz.*, either the secured party must have taken possession of the collateral or the debtor must have signed a security agreement that meets the collateral description requirements set out in section 10.

Requirement that Value be Given

Under the existing law, a security interest cannot attach unless and until there is some outstanding debt or other obligation between the parties to be secured. A similar notion is expressed in PPSA section 12(1)(a) in terms of a requirement that "value is given". "Value" is defined in section 1 to mean "any consideration sufficient to support a simple contract, and includes an antecedent debt or liability". This largely reflects existing views on value in this context. However, in expressly stating that a pre-existing debt *ipso facto* qualifies as value, the PPSA dispenses with any need to formally plead that the secured party's willingness to forbear suit on the old debt constitutes sufficient new consideration for the security interest. But any arrangement for the conversion of a previously unsecured debt to a secured debt will of course be subject, as before, to the New Brunswick law on fraudulent conveyances and preferences and to federal bankruptcy law on reviewable transactions.

Requirement that Debtor have Rights in the Collateral - Generally

A debtor obviously cannot give a security interest in anything in which she has no shadow of an interest or power of disposal. This common sense idea is expressed in PPSA section 12(1)(b) in terms of a requirement that the debtor must have "rights in the collateral" before a security interest will attach. Under existing law, it is clear that a *real* interest falling short of full title or ownership may still be mortgageable[1] and the use of the phrase "rights in the collateral" in section 12 is intended to express the same idea. But aside from the specific cases dealt with in sections 12(2) and (3), the PPSA otherwise leaves it to the courts to determine what kinds of *real* rights will suffice for attachment purposes. In this respect, the jurisprudence in PPSA jurisdictions and under the UCC suggests three things. Firstly, the courts generally take a substantive rather than a formalistic view of the question. Secondly, this is one area where common law, equitable and other statutory property rules as preserved by section 65(1) will continue to have relevance. Finally, and perhaps most importantly, a finding that the debtor has sufficient rights in the collateral to permit attachment is a "ticket of entry" enabling the secured party to participate in a priority contest with *real* interests in the same collateral. In this way, then, the requirement that the debtor have rights in the collateral acts as a kind of bulwark against a floodgate of competing priority claims.

Requirement that Debtor have Rights in the Collateral - Possession under a Lease or Consignment

Sections 12(2) provides that for the purposes of attachment under section 12(1), a debtor acquires sufficient rights in goods leased or consigned to her when she obtains possession of the goods under the lease or consignment. Before too much alarm is taken at this notion, it must be remembered that the attachment of a security interest and its priority status are separate and distinct things. That is to say, the fact that a debtor has rights in the collateral sufficient to permit the security interest to come into existence does not mean that that security interest will then automatically override other real interests in the collateral, such as those of the lessor or consignor of goods. Attachment, as noted above, is merely a necessary "ticket of entry" to enable the security interest to even participate in a priority contest with other real interests in the same collateral. In the case of a lease or consignment, the lessor or consignor's pre-existing ownership rights will normally prevail unless they fail to register their interest when and as required: see further sections 2 and 3.

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[1] For instance, a conditional sale of goods gives the buyer an interest in the goods that may be mortgaged, notwithstanding the vendor's retention of title: *Sharp v. Ingles* (1915) 23 DLR 636 (BCCA)

Requirement that Debtor have Rights in the Collateral: Crops, Minerals, Trees and the Unborn Young of Animals

Section 12(3) provides express guidance on the moment when the debtor acquires rights in the collateral in four troublesome cases. Three of these cases involve categories of property at the borderland between real and personal property: crops, trees and minerals. Section 12(3) provides that the debtor has no rights in crops until they become growing crops, in minerals until they are extracted, and in trees other than crops until they are severed[2]. The fourth case is the unborn young of animals, a category of future property about which there is little authority. Section 12(3) provides that the debtor has no rights in the young of animals until they are conceived.

Requirement that Section 10 evidentiary requirements be satisfied

Earlier generations of the PPSA inadvertently failed to mesh the section 10 evidentiary requirements with the requirements for attachment, making it possible for a security interest to attach even as against third parties before the evidentiary requirements had been satisfied. Section 12(1)(c) is intended to make it clear that except for *inter partes* purposes, a security interest does not attach until the security agreement has become enforceable within the meaning of section 10 of the Act. This approach is not unlike that taken under the existing registration statutes under which a security interest may exist *inter partes* but will be treated as void against third parties unless it is reduced to writing and registered in the relevant registry. The main difference is that under the PPSA notice filing system, the writing requirements for security agreements and for registration have been separated: see further section 10.

Attachment of Floating Charges

Under equitable principles, a so-called "floating charge" security interest hovers over the collateral without attaching to any specific asset until it is crystallized. Under earlier generations of the PPSA, the door was left open to argue that where the security interest was expressed to be in the nature of a floating charge, the parties could not have intended it to attach until it had crystallized. While the courts proved to be generally unsympathetic to this argument, section 12 puts the issue beyond further argument or doubt. Firstly, the prerequisites to attachment under section 12 apply to *all* security interests without exception and section 2 makes is abundantly clear that a floating charge security falls within the PPSA concept of security interest. Secondly, section 12 creates a positive presumption that attachment occurs so soon as the three prerequisites are satisfied. Once value is given, the debtor has rights in the collateral, and either a security agreement is signed or possession is taken, the security interest will attach, regardless of whether the interest is fixed or floating. This is not to say that the parties no longer retain the freedom to postpone attachment if for some reason this seems desirable. But there is no longer any room to imply a postponement based simply on the nature of the security interest involved or an implied intention for postponement. If the parties wish to postpone attachment, section 12 requires that they enter into a specific agreement to that effect. Finally, the tendency to use floating charge terminology will in any event inevitably wither away with the years as the PPSA takes hold.

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[2] At common law, when timber is sold with the right to cut it, it becomes a personal chattel as soon as it is severed: *Murray v. Gilbert* 12 NBR 553.

SECTION 13

SECURITY IN AFTER ACQUIRED PROPERTY

13(1) **Subject to section 12 and subsection (2), a security agreement that provides for a security interest in after-acquired property attaches to that property in accordance with the terms of the agreement without any need for specific appropriation by the debtor.**

13(2) **A security interest does not attach to after-acquired property that is**

(a) **a crop that becomes a growing crop more than one year after the security agreement has been entered into, except that a security interest in crops that is given in conjunction with a lease, agreement for sale or mortgage of land may, if the parties so agree, attach to a crop to be grown on the land concerned during the term of the lease, agreement for sale or mortgage, or**

(b) **consumer goods, other than an accession, unless the security interest is a purchase money security interest or a security interest in collateral obtained by the debtor as replacement for collateral described in the security agreement.**

COMMENTARY

Historical Background and Existing Law

The subject of section 13 is security in after-acquired assets. At common law, an agreement to mortgage after-acquired property was ineffective without a fresh conveyance or other act of specific appropriation following the debtor's acquisition of the collateral. Left unmodified, the common law prejudice against future security would have precluded commercial financing on the security of a debtor's fluctuating assets or general business undertaking. But in the wake of the demand for capital created by the Industrial Revolution, equity intervened to permit future assets financing. Operating on the maxim "equity regards as done that which ought to be done", an agreement to grant security in after-acquired assets was regarded as sufficient to transfer a security interest in the assets immediately they were acquired by the debtor without the necessity for a fresh act[1]. However, equity also "follows the law" and a security interest in after-acquired property, being purely equitable in nature, is therefore subordinated to a subsequent sale, pledge or mortgage of the legal title in the collateral[2].

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[1] The seminal English cases are *Holroyd v. Marshall* (1862) 11 ER 999, [1861-73] All ER Rep 414 (HL) and *Tailby v. Official Receiver* (1888) 13 App Cas 523 at 545-49 (HL). Early New Brunswick cases on the point include *Lloyd v. European, etc. R. Co.* 18 NBR 194, *Vassie v. Vassie* 22 NBR 76 and *Fraser v. Macpherson* 34 NBR 417.

A subsequent legal interest in collateral enjoys priority, however, only if it takes without notice of the prior equitable title. Thus the advent of the registration statutes created an opportunity for future assets financiers to advance their priority status if the courts could only be persuaded to accept the position that registration of a security interest is constructive public notice of its existence to subsequent legal interests. But Canadian courts traditionally have been unwilling to accept the constructive notice doctrine in this context[3]. It is only in very recent years with the advent of PPSA reform that judicial attitudes have softened on the issue[4] at least to the extent of imposing constructive notice on all those who can reasonably be expected to search the registry such as other secured parties subject to the same registration requirement.

The common law prejudice against future assets financing is not totally lacking in policy justification. At common law priority is determined by the order of creation of the competing interests under the maxim *nemo dat quod non habet*. Thus to recognize a security interest in future assets as effective at law would effectively have enabled a secured party to gain a monopoly over the debtor's financing needs by taking a general security interest in all present and future assets. So long as the security interest was treated as effective only in equity, the legal interest in specific assets remained available to secure more specialized sources of financing. A judicial desire to protect *bona fides* purchasers for value without notice from the harshness of the *nemo dat maxim* no doubt also explains the legal/equitable priority ranking.

The PPSA Approach

The PPSA expressly permits security interests in after-acquired property and eliminates any distinction between legal and equitable interests. Under section 13, a security interest under a security agreement that covers after-acquired property will attach in accordance with the attachment criteria set out in section 12 without the need for any specific appropriation of the collateral to the security by the debtor. If classification were needed, the effect of the provision is to convert all interests in future-acquired assets into statutory and therefore legal interests on an equal par with security interests in present assets. But classification is not needed because the PPSA's detailed priority code means that priority will now turn on the rules of the Act rather than the nature of the interest created. That is to say, recognizing the "legality" of a security interest covering future property does not mean that the secured party thereby will enjoy a monopolistic first priority against all subsequent interests. To give two prominent examples, section 34 guarantees purchase money financiers a "superpriority" over all other security interests in the same collateral whether prior or subsequent and sections 30 and 31 protect *bona fides* transferees of the collateral against a prior general security interest in circumstances where it would be unfair to impose it on them.

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[2] The seminal authority on the vulnerability of equitable security interests in after-acquired property to subsequent legal interests is *Joseph v. Lyons* (1884) 15 QBD 280 (CA).

[3] See *Re Hepburn* (1980) 112 DLR 3d 474 (Alta) for a survey of the Canadian caselaw. The leading modern New Brunswick case is *GMAC v. Hubbard* (1978) 84 DLR 3d 39 (NBCA).

[4] *Acmetrack Limited v. Bank Canadian National* (1984) 52 CBR (NS) 235 (Ont CA)

Growing Crops and Consumer Goods Exceptions

Section 13(2) prohibits security in future assets in two cases: growing crops that become such more than one year prior to the security agreement and consumer goods. The growing crops exception is meant to prevent agricultural producers, who are especially vulnerable to sudden and severe economic setbacks, from mortgaging all their future expectations. The consumer goods exception is directed at so-called "add-on plans" under which a financier will purport to make all present and future items purchased by the debtor stand as collateral for their cumulative purchase price so that the debtor never acquires ownership of any item until the entire debt is paid. Add on security has little social value and is used for its *in terrorarum* effect more than anything. Section 13(1) effectively limits a secured party's ability to add on additional collateral other than the very collateral for which the money was advanced and any specific replacement collateral.

NOTES

SECTION 14

FUTURE ADVANCES

14(1) **A security agreement may provide for future advances.**

14(2) **Unless the parties otherwise agree, an obligation owing to a debtor to make future advances is not binding on a secured party if the collateral has been seized, attached, charged or made subject to an equitable execution under circumstances described in section 20(1)(a)(i) or (ii) and the secured party has knowledge of this fact before making the advances.**

COMMENTARY

Future Advance Clauses - General Validity

While section 13 validates security agreements that cover after acquired property, section 14 completes the picture by validating agreements that provide for future advances. Together, the two sections provide the maximum flexibility capable of being enjoyed by a secured party - the ability to contract for an effective security interest in a fluctuating fund of present and future assets to secure a fluctuating line of present and future advances. This ability is especially useful for inventory and accounts financiers.

While existing law also recognizes the validity of security agreements that cover advances made after the agreement is executed, the registration statutes hamper their utility. The *Bills of Sale Act* requires the secured party to file detailed information on the amount and nature of future advances. Even the *Corporations Security Registration Act* demands filing of the secured sum. Compliance with these statutory requirements is not always feasible. The PPSA notice filing system eliminates the need to publicly state and register the details of the future advances to be made at the time of taking security on pain of losing the effectiveness of the security interest against third parties. Third parties with a legitimate interest in knowing the current state of the financing between the parties can find out directly from the secured party through the procedure set out in section 18.

It must be emphasized that section 14 does not automatically entitle a secured party to "tack" any and all future indebtedness to its initial security. As under the existing law, the security agreement must expressly state that the security is to cover future advances. The right to tack future advances, in other words, is a matter of contract and not a rule of substantive law. This is necessary in the interests of debtor protection since an automatic right to increase the dollar value of security by the amount of any future debt could hamper the debtor's ability to obtain further financing from other sources down the line.

When Secured Party Released from Obligation to Make Future Advances

At common law, a secured party who has contracted for future advances nonetheless loses its priority for advances made after it has knowledge of an intervening security interest[1]. Section 35(4) of the PPSA eliminates this exception and the secured party will enjoy the same priority against intervening secured parties for future advances as it does for prior advances. However, the rule is different where the intervening third party is one of the classes of third parties listed in section 20(1)(a) of the Act; *viz*, execution creditors who have caused the collateral to be seized and the debtor's trustee in bankruptcy. Under section 35(6) of the Act, the secured party will be subordinated to the interests of such persons to the extent of advances made after it acquires knowledge of their interests. It is for this reason that section 14(2) provides that the secured party is released from any obligation to the debtor to make future advances if the collateral has been seized or attached under the circumstances described in section 20(1)(a) and the secured party has knowledge of this fact before making the future advances. See further the commentary on section 35.

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[1] The rule was conceived and applied to real property mortgages in *Hopkinson v. Rolt* (1861) 9 HL Cas 514 and its applicability to chattel mortgages confirmed by *West v. Williams* [1899] 1 Ch 132 (CA). The rule applies to successive mortgages or charges on intangibles as well as chattels: *W H Fraser v. Imperial Bank of Canada* (1912) 47 SCR 313. More recently, see *Siebe Gorman & Co Ltd v. Barclay's Bank Ltd* [1979] 2 Ll Rep 141.

SECTION 15

APPLICATION OF SALES LAW

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15 **Where a seller has a purchase-money security interest in goods, the law relating to contracts of sale, including a disclaimer, limitation or modification of the seller's performance obligations with respect to the goods, governs the sale.**

COMMENTARY

Though cast in the form of a conveyance, the essential purpose of a chattel mortgage agreement is to create an interest in collateral as security for a loan advance. In contrast, a conditional sales contract is both a true sales agreement and a security agreement. That is to say, the fact that the seller in this particular variety of sales contract reserves title to the goods as security for the payment of the purchase price does not displace the normal application of sale of goods law to the seller-buyer aspect of the parties' relationship[1].

Under the PPSA, a conventional conditional sales contract is classified as a purchase money security interest for PPSA purposes. Section 15 is intended to make it clear that where the PMSI takes the form of a conditional sales contract, the sales aspect of the parties' relationship continues to be regulated by sales law including the *Sale of Goods Act* and the *Consumer Products Warranty and Liability Act*. Like the *Conditional Sales Act* presently, the PPSA is intended to govern only the secured party-debtor aspect of the parties' relationship.

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[1] *Sale of Goods Act*, sections 2(2) and 2(3) and see *GMAC v. Hubbard* (1978) 87 DLR 3d 39 (NBCA). See also *Consumer Product Warranty & Liability Act*.

NOTES

SECTION 16

ACCELERATION CLAUSES

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16 **Where a security agreement provides that a secured party may accelerate payment or performance if it considers that it is insecure or the collateral is in jeopardy, the security agreement shall be construed to mean that the secured party has the right to do so only if it, in good faith, believes and has commercially reasonable grounds to believe that the prospect of payment or performance is or is about to be impaired or that the collateral is or is about to be placed in jeopardy.**

COMMENTARY

Security agreements that provide for payments at fixed intervals generally include a so-called acceleration clause whereby on the happening of a certain event, the entire outstanding indebtedness becomes immediately due at the secured party's option. Commonplace acceleration events are nonpayment of any part of the secured obligation when due, nonperformance by the debtor of other duties required under the security agreement, an attempted sale of the collateral, the debtor's death, bankruptcy or insolvency and the suffering of unpaid judgments. Acceleration clauses of this type are not regulated by the PPSA in any way (subject to the debtor's right of reinstatement under section 62) and are ordinarily given effect to under the general law.

Acceleration clauses sometimes also empower the secured party to accelerate payment when it is or believes itself to be insecure or decides that the collateral is in jeopardy. If the right to accelerate payment under this type of clause were allowed to depend solely on the secured party's subjective assessment of the debtor's financial and other circumstances, it would be open to potential abuse or misuse by a capricious or overly skittish or even malevolent secured party. At common law, such clauses, however liberally drafted, were therefore interpreted to require a *bona fide* feeling of insecurity[1] based on objectively reasonable grounds[2]. Section 16 likewise aims to prevent the use of such clauses for reasons unrelated to the prospect of performance by the debtor or on the basis of objectively unfounded fears; the secured party may act only if it "in good faith believes and has commercially reasonable grounds to believe that the prospect of payment or performance is about to impaired or that the collateral is or is about to placed in jeopardy"[3].

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[1] *Westaway v. Stewart* (1909) 10 WLR 623, 2 Sask LR 178, affirming 8 WLR 907, 1 Sask LR 200 (CA)

[2] See, for instance, *Peterson v. Johnston* (1911) 17 WLR 596 (Sask); *Meincke v City Dairy Ltd (No 2)* [1932] 2 WWR 398, 40 Man R 465

[3] See generally Nowak, "Standards for Insecurity Acceleration under Section 1-208 of the Uniform Commercial Code", 13 U Mich J L Ref 623 (1980)

Once the secured party exercises its acceleration power, the debtor will generally have to pay the entire outstanding debt in order to redeem the collateral under the existing law. However, PPSA section 62 gives the debtor the right to cure a default and reinstate the security agreement by paying the sum actually in arrears "exclusive of the operation of any acceleration clause": see further the commentary on section 62.

SECTION 17

COLLATERAL IN THE SECURED PARTY'S POSSESSION: RIGHTS AND OBLIGATIONS

17(1) **In this section, "secured party" includes a receiver.**

17(2) **A secured party shall use reasonable care in the custody and preservation of collateral in the possession of the secured party and, unless the parties otherwise agree, in the case of chattel paper, a security or an instrument, reasonable care includes taking necessary steps to preserve rights against other persons.**

17(3) **Unless the parties otherwise agree, if collateral is in the secured party's possession,**

- **(a)** **reasonable expenses, including the cost of insurance and payment of taxes or other charges incurred in obtaining maintaining possession of and preserving the collateral, are chargeable to the debtor and are secured by the collateral,**
- **(b)** **the risk of loss or damage, except if caused by the negligence of the secured party, is on the debtor to the extent of any deficiency in any insurance coverage,**
- **(c)** **the secured party may hold as additional security any increase or profits, except money, resulting from the collateral, and shall apply any money so received, unless remitted to the debtor, immediately upon its receipt in reduction of the obligation secured, and**
- **(d)** **the secured party shall keep the collateral identifiable, but fungible collateral may be commingled.**

17(4) **Subject to subsection (1), a secured party may use the collateral**

- **(a)** **in the manner and to the extent provided in the security agreement,**
- **(b)** **for the purpose of preserving the collateral or its value, or**
- **(c)** **pursuant to an order of a court.**

COMMENTARY

Purpose

The subject of section 17 is rights, remedies and duties with respect to collateral in the secured party's possession. For the most part, it is a restatement of common law and commercial precedents on the subject.

Collateral may come into the secured party's possession before default as where taking possession is chosen as an alternative perfecting step to registration. Or the secured party may take possession after default for the purposes of enforcement pursuant to PPSA Part 5. Section 17 applies to both pre-default and post-default possession. Its application in the latter context is expressly reconfirmed by section 56(1) which provides that in addition to the rights and remedies provided in Part 5 and in the security agreement, the secured party when in possession has "the rights, remedies and obligations provided in section 17" and the debtor has "the rights and remedies provided...in section 17".

The Duty of Care - Generally

Although a secured party in possession of collateral is holding property in which it has an interest, its possession - whether taken before or after default - does not give it the rights of an absolute owner. In the case of pre-default possession, the property will have to be returned to the debtor if the secured obligation is paid or performed when due. In the case of post-default possession, Part 5 of the PPSA vests in the debtor (and others with and interest in the collateral) certain rights regarding the disposition of the collateral, including a right to cure a default and demand a return of the property and a right to any surplus which may result from a subsequent sale of the collateral. Any abuse or misuse of the collateral while in the secured party's possession, to the extent it diminishes its value, is prejudicial to the debtor's equity therein. Accordingly, the first part of section 17(2) imposes on the secured party a general duty of reasonable care in the care, custody and preservation of collateral in its possession. This duty cannot be contracted out of. What constitutes reasonable care will continue to be determined by the judges and pre-PPSA case law on the duties of pledgees and mortgagees in possession will continue to be relevant.

The Duty of Care - Chattel paper, securities and instruments

Where the collateral takes the form of tangible personal property, the secured party's duty of reasonable care will primarily go to preserving its physical state. But where the collateral consists of chattel paper, a security or an instrument, preservation of its value may sometimes require the secured party to take steps to preserve rights against third parties as, for instance, taking the necessary steps to prevent discharge of an indorser on a negotiable instrument. The second part of section 17(2) confirms that the secured party's duty of care includes taking such steps. This aspect of the secured party's overall duty may, however, be made the subject of contrary agreement.

Other Rights and Duties

The mandatory duty of reasonable care cast on a secured party in possession by section 17(2) is counterbalanced by section 17(3) which otherwise casts on to the debtor all the risks and costs associated with the secured party's possession of the collateral while preserving to the secured party all the privileges associated with possession.

All of the rights and duties imposed by section 17(3) may be made the subject of contrary agreement. This is natural. These rights and duties are derived not so much from any rule of law but from general commercial practice. As such, they are included in the Act as a convenience, a statutory equivalent of boilerplate contract language relieving the parties from the necessity of having to express their implied intention.

The Secured Party's Expenses

The secured party is not required to draw on its own pocketbook in discharging its duty of reasonable care of the collateral. Section 17(3)(a) provides that all reasonable expenses incurred in taking and maintaining possession of the collateral and preserving its value are not only chargeable to the debtor but are also secured by the collateral[1]; thus, the debtor is liable both personally and through a diminution of the value of its "equity" in the collateral. Reasonable expenses expressly include the cost of insurance, payment of taxes and other charges.

The Risk of Accidental Loss

Under section 17(3)(b), the risk of accidental loss or damage to the collateral is also cast on the debtor. The liability for loss or damage is naturally borne by the debtor only if it was not caused by the negligence of the secured party - otherwise the duty of reasonable care imposed by section 17(2) would be meaningless. Furthermore, the debtor becomes personally liable for loss or damage "only to the extent of any deficiency in any insurance coverage". The secured party, in other words, cannot collect both the insurance proceeds and the debt.

Increase and Profits

Section 17(3)(c) gives the secured party the benefit of any increase or profits resulting from the collateral while in its possession. Where these take a non monetary form, the young of animals, for instance, they may be held by the secured party as additional security. Where they take the form of money, they must be either remitted to the debtor or applied in reduction of the outstanding secured obligation.

Duty to keep Collateral Identifiable

Section 17(3)(d) obligates the secured party or sheriff to keep the collateral identifiable except that fungible collateral, such as grain, may be commingled with similar collateral, such as storing it in a warehouse.

Secured Party's Right to Use the Collateral

Since the secured party is in possession as such and not as owner, it is not entitled to the use and enjoyment of the collateral in its possession for its own pleasure or ends. But the secured party may sometimes be required to use the collateral in the discharge of its duty of care and preservation, as for instance, in the case of equipment or machinery that is subject to deterioration unless kept in at least occasional use. Sometimes, too, the secured party may receive express authorization to use the collateral. Agreements granting the secured party the right to use the collateral are common when the collateral is income-producing and the debtor is a commercial enterprise especially if enforcement is through a receivership. Court orders to this effect are also common at least in the case of post-default possession. Provided there is no conflict with the secured party's overriding duty of care under section 17(2), there can be no objection and much advantage to either an authorized use or a necessary use. Accordingly, section 17(4) authorizes the secured party to use the collateral, subject to section 17(2), "for the purpose of preserving the collateral or its value" or "in the manner and extent provided in the security agreement" or "pursuant to an order of a court".

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[1] See also section 59(1) which provides that the proceeds of a post-default disposition of the collateral by the secured party shall be applied firstly to the reasonable expenses of seizing, holding and disposing of the collateral.

SECTION 18

OBTAINING INFORMATION ABOUT THE SECURITY AGREEMENT

18(1) The debtor, a creditor, a sheriff, a person with an interest in personal property of the debtor, or an authorized representative of any of them, may, by a demand in writing containing an address for reply and delivered to the secured party,

(a) at its most recent address set forth in a registered financing statement that relates to the property, or

(b) at a more recent address if known by the person making the demand, or

(c) where there is no address in the registry, at the current address of the secured party,

require the secured party to send or make available the information specified in subsection (2) to the person making the demand or, if the demand is made by the debtor, to any person at an address specified by the debtor.

18(2) The information that may be demanded under subsection (1) may be one or more of the following

(a) a copy of any security agreement providing for a security interest held by the secured party in the personal property of the debtor,

(b) a statement in writing of the amount of the indebtedness and of the terms of payment of the indebtedness, as of the date specified in the demand,

(c) a written approval or correction of an itemized list of personal property attached to the demand indicating which items are collateral as of the date specified in the demand,

(d) a written approval or correction of the amount of indebtedness and of the terms of payment of the indebtedness, as of the date specified in the demand,

(e) sufficient information as to the location of the security agreement or a copy of it to enable a person entitled to receive a copy of the security agreement to inspect it.

18(3) A person with an interest in personal property of the debtor is entitled to make a demand under subsection (1) only with respect to a security agreement providing for a security interest in the property in which the person has an interest.

18(4) The secured party, on the demand of the person entitled to receive a copy of the security agreement under subsection (1), shall permit the person to inspect the security agreement or a copy of it during normal business hours at the location referred to in subsection 2(e).

18(5) Where a demand is made in accordance with subsection (2)(c) and the secured party claims a security interest in all of the personal property of the debtor, in all the property of the debtor other than a specified kind or item of property or in all of a specified kind of property of the debtor, the secured party may indicate this in lieu of approving or correcting the itemized list of the property.

18(6) The secured party shall comply with a demand under subsections (1) or (4) not later than

(a) 25 days after receiving it, where the secured party is a trustee under a trust indenture, or

(b) 10 days after receiving it, in the case of any other secured party.

18(7) If, without reasonable excuse, the secured party fails to comply with a demand under subsection (1) within the time specified in subsection (6) or her reply incomplete or incorrect, the person making the demand, in addition to any other remedy provided by this Act, may apply to the court for an order requiring the secured party to comply with the demand.

18(8) If a person receiving a demand under subsection (1) or (4) no longer has an interest in the obligation or property of the debtor that is the subject of the demand, that person shall, not later than 10 days after receiving the demand, disclose the name and address of the immediate successor in interest and, if known, the latest successor in interest.

10(9) If, without reasonable excuse, the person receiving the demand fails to comply with subsection (8), the person making the demand may, in addition to any other remedy provided in this Act, apply to the Court for an order requiring the person to whom the demand was made to comply with subsection (8).

18(10) On an application under subsections (7) or (9), the Court may make an order requiring the secured party or the person receiving the demand to comply with the demand or to disclose the information, as the case may be.

18(11) The court may provide for the actual or possible failure of a secured party to comply with an order under subsection (10) by making one or more of the following orders either on application or as part of the order under subsection (10):

(a) any order that the court considers necessary to ensure compliance with the demand;

(b) in the case of noncompliance by a secured party or the person receiving the demand, an order that the security interest of the secured party with respect to which the demand was made is unperfected or extinguished and that any related registration be discharged.

18(12) On an application under subsection (7) or (9), or on an application of the secured party referred to in subsection (7) or the person referred to in subsection (8), the court, subject to section 66, may

(a) exempt the secured party or person receiving the demand in whole or in part from complying with subsection (6) or (8), unless the demand is made by the debtor, or

(b) extend the time for compliance.

18(13) A secured party who has replied to a demand referred to in subsection (1) is estopped, for the purposes of this Act, as against the person making the demand and any other person who can reasonably be expected to rely on the reply, to the extent that the person has relied on the reply, from denying

(a) the accuracy of the information contained in the reply to the demand under subsections (2)(b), (c) or (d), and

(b) that the copy of the security agreement referred to in subsection (2) that is provided in response to a demand under subsection (1) is a true copy of that security agreement.

18(14) A successor in interest referred to in subsection (8) is estopped, for the purposes of this Act, as against the person making the demand referred to in subsection (1), and any other person who can reasonably be expected to rely on the reply to the demand, to the extent that the person has relied on the reply, from denying

(a) the accuracy of the information referred to in subsections 2(b), (c) or (d), and contained in the reply to the demand, and

(b) that the copy of the security agreement referred to in subsection 2(a) that is provided in response to a demand under subsection (1) is a true copy of that security agreement.

18(15) A successor in interest referred to in subsection (8) is not estopped under subsection (14) where

(a) the person making the demand knows the identity and address of the successor in interest, or

(d) prior to the demand, a financing change statement has been registered as provided in section 45 disclosing the successor in interest as the secured party.

18(16) The person to whom a demand is made under this section may require payment in advance of a fee in the amount prescribed for each demand, but the debtor is entitled to a reply without charge once every six months.

18(17) A secured party who receives a demand that purports to be made by a person entitled to make the demand under subsection (1) may act as if the person is entitled to make the demand unless the secured party knows that the person is not entitled to make it.

COMMENTARY

Purpose

Under the existing personal property security registry systems, the secured party must register a copy of the actual security documentation. The PPSA replaces documentary-filing with notice-filing, a concept that those familiar with section 178 *Bank Act* security will be familiar. In a notice-filing system, the secured party registers a simple notice document which sets out only the bare information necessary to alert a searcher that a security interest may exist in the described collateral and where to go to procure further information. Under the PPSA version of notice-filing, the registered notice document - called a "financing statement" - may be registered before the actual security agreement is entered into and may cover successive security agreements. A registry searcher who wishes to know whether a security interest has in fact been taken and, if so, in what collateral and for what indebtedness, must contact the secured party directly. In most cases, of course, the secured party will be quite content to supply the relevant information voluntarily at least so long as the debtor concurs. What section 18 does is establish a statutory procedure so as to *ensure* full disclosure should the secured party prove less than cooperative, an approach which also protects the secured party from allegations of breach of confidentiality on the part of the debtor.

Who may Make a Demand?

Under the existing documentary filing systems, the intimate details of a secured financing arrangement are a matter of general public record, available to anybody who wishes to search. One of the benefits of the PPSA notice filing system is that it better ensures the confidentiality of the parties' affairs by limiting third party access to detailed information on the current status of any security transaction for which a financing statement has been registered. Section 18(1) limits the classes of persons entitled to demand further information from the secured party to those who may be presumed by their very status to have a legitimate interest in knowing. They are the debtor, a creditor, a sheriff or a person with an interest in the personal property of the debtor, or an authorized representative of any of them.

The inclusion of the debtor as a person entitled to invoke the section 18 procedure fulfills two purposes. Firstly, it supplements the secured party's obligation under section 11 to deliver a copy of the security agreement to the debtor within 10 days of execution by providing a means for the debtor to later procure up to date information on the status of the financing arrangement during its currency. Secondly, the debtor is entitled under section 18(1) to require the secured party to forward the requested information directly to any third party at an address specified by the debtor. This allows the section 18 procedure to be used by the debtor as a means of providing direct information to persons, such as prospective secured or unsecured creditors, who do not have the status to make a direct demand.

The secured party must supply on demand up to date information on the current state of the debt(s) and itemize the collateral subject to the security agreement(s). The person making the demand may also submit a list of items and require the secured party to indicate which of these items are subject to a security interest as of the date of the demand. As a general rule, the secured party may also be required to supply a copy of any and all security agreements entered into with the debtor. To this rule, there is only one exception: where the demand is made by a person with an interest in the personal property of the debtor, the secured party need only a supply a copy of that security agreement which relates to the specific property in which that person has an interest. Such persons do not have a legitimate reason to know the details of the debtor's overall financial arrangements. Creditors, including secured creditors, are in a different position. In order to assess their current risk, and in order to decide whether and when execution or enforcement should issue and against what, they will need an accurate picture of the full scope of the financing arrangement with the secured party.

Rather than having to wait for a reply through the mail to a demand for information under subsection (1), the person making the demand may wish to take the initiative and inspect the security agreement. This alternative is contemplated by section 18(2)(e) which obligates the secured party to provide information on the location of the security agreement on demand and by section 18(4) which then obligates the secured party to permit inspection of the agreement at the disclosed location during normal business hours.

Section 18(6) sets a strict time limit on the secured party's obligation to reply to a demand for information under subsection (1) or to respond to a demand to permit inspection of the security agreement under subsection (4). The secured party is given 10 days to comply except where the secured party is a trustee under a trust indenture. In that event, the compliance period is extended to 25 days in order to ensure that the trustee has sufficient time to procure the relevant information from the indenture holders.

Protecting the Secured Party and Easing the Inquiry Burden

The limitations on the classes of third parties entitled to make a demand is one mechanism for protecting the secured party from the burden of frivolous or prolix requests for information. There are others. Section 18(16) entitles the secured party to require advance payment of a prescribed fee for each demand (except that the debtor is entitled to a free reply once every six months.) And section 18(4) releases the secured party from the need to itemize every item of collateral subject to its security interest in situations where the secured party claims a security interest in all of the debtor's property, or all of certain kind of the debtor's property or all of the property save certain items. Finally, section 18(17) provides that the secured party is entitled to act as if a person making a demand is entitled to do so under section 18(1) unless it knows otherwise. This effectively releases the secured party from any obligation to take positive steps to verify the status of the person making the demand in order to protect itself from a possible liability to the debtor for breach of confidentiality.

Effect of Transfer of Security Interest

As under the existing law, the PPSA does not require the registration to be amended to disclose a transfer or assignment of the secured party's security interest. Disclosure is permissive only: see section 45. This makes sense: since the primary search criterion is the debtor's name rather than the secured party's, the ability of third parties to search is not prejudiced by the transfer. On the other hand, if the transfer is not disclosed on the record, requests for information under section 18(1) will continue to be addressed to the original secured party. Section 18 addresses this possibility and requires the secured party to disclose the name and address of its immediate successor in interest (as well as the current successor if known) within ten days of receipt of the demand. Moreover, section 18 protects third parties in the event that the secured party fails to disclose the transfer and supplies inaccurate information in response to a demand. Under section 18, the successor in interest is estopped from denying the accuracy of information supplied in response to a demand under section 18(1) as against any persons who reasonably relied to their detriment upon the reply unless they either knew the name and address of the successor or the original registration has been amended to disclose the successor in interest as the secured party. The potential risk that this entails for successors in interest should encourage them to make a timely disclosure of their interest on the registry.

NOTES

PART 3
PERFECTION AND PRIORITIES

SECTION 19

ATTAINING PERFECTION

19 A security interest is perfected when

(a) it has attached, and

(b) all steps required for perfection under this Act have been completed,

regardless of the order of occurrence.

COMMENTARY

The Concept of Perfection

Attachment denotes the moment in time when a security interest can be said to exist[1]. Attachment normally suffices for the purposes of enforcing the security interest against the debtor. But in order to make it effective against third parties, the PPSA also requires that the secured party "perfect" it by performing some act of public notice.

As a legal term of art, "perfection" only came into Canadian law with the PPSA and derives from Article 9 of the UCC which in turn borrowed it from American bankruptcy law. But while the term "perfection" may be somewhat novel, the underlying notion of publicity is as old as the common law of personal property security. So are the rationales. Before looking at the concept of perfection under the PPSA, it will therefore be useful to first trace its historical evolution up to its present stage of development in New Brunswick law.

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[1] See further the commentary on section 12.

Perfection: Historical Evolution and Existing Law

Chattel Security

In the case of security in chattels, the principle of perfection or publicity can be traced back to *Twyne's Case*[2] in 1600[3]. One Pierce had conveyed his sheep to Twyne as payment for a preexisting debt. However, Pierce remained in possession of the sheep as ostensible owner, shearing and marking them as his own. It was only when another of Pierce's creditors had the sheep seized under a writ of execution that Twyne came forward to assert his title. Edward Coke, then Attorney General, brought action against Twyne in the Star Chamber. From that action, there emerged a rule that was to influence the shape of chattel security law for the next several centuries: all transfers of chattel, whether absolute or by way of security, were to be deemed fraudulent and void as against the transferor's execution creditors and as against subsequent mortgagees and purchasers of the goods from the transferor unless possession of the goods was transferred along with the title[4].

Applied to subsequent purchasers and mortgagees, the rule in *Twyne's Case* is commonly explained by theories of estoppel and reliance. So long as the transferor remained in possession of goods as ostensible owner after they had been sold or mortgaged, subsequent purchasers and mortgagees could be misled into giving value in ignorance of the prior transfer. *Twyne's Case* protected their reliance interest by holding that the secret nature of the prior transfer made it fraudulent and void as against those who parted with value in ignorance of the true state of title.

But when applied to protect the transferor's execution creditors, as happened in *Twyne's Case* itself, the rule against non-possessory transfers cannot be readily explained on a theory of reliance. Unlike subsequent purchasers and mortgagees, unsecured creditors do not rely on the debtor's apparent ownership of any specific assets when deciding to part with their funds. On the contrary, their very act of extending credit on an unsecured basis imports risk, not reliance[5].

The original rationale for protecting execution creditors against secret transfers stemmed instead from the law of fraudulent conveyances and preferences and was based on efficiency values. Without a transfer of possession, there was no objective concrete evidence to say whether the alleged prior transfer was honest or a sham put up after the fact by the debtor in collusion with a preferred creditor to defeat or hinder the debtor's other creditors when execution threatened. In *Twyne's Case*, the Star Chamber therefore erred on the side of caution, calling in aid an evidentiary presumption that the secrecy should be *ipso facto* treated as a "badge of fraud". By requiring a transfer of possession to "perfect" the transfer, the rule averted the expense of litigation and the risk of perjury[6].

Requiring that the secured party take possession of the collateral to perfect the security interest worked well enough so long as the pledge or pawn was the only security device in significant use. But the Industrial Revolution changed everything. The process of industrialization itself created an enormous ongoing demand for credit capital which because of the inherent risks involved could only be met though secured credit. Industrialization also brought about a dramatic shift in the balance of a debtor's valuable assets from land to personal property. The obvious answer to the urgent demand for secured credit was to make the new assets generated by the industrialization process itself available as collateral. Yet assets such a the debtor's industrial equipment and stock-in-trade were useless to both parties as sources of collateral unless they could remain in the debtor's possession.

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[2] 13 Co Rep 80b, 76 ER 809 (Star Ch)

[3] For a good general discussion, see Douglas G. Baird, "Notice Filing and the Problem of Ostensible Ownership" (1983) 12 Journal of Legal Studies 53-67

[4] In New Brunswick, see *Sheriff v. Mckeen* 23 NBR 184.

[5] For a discussion of the distinction between the reliance interests of unsecured creditors and subsequent purchasers and mortgagees under the existing law, see Catherine Walsh, *Case Comment on Borg-Warner Acceptance v. Bank of Montreal* (1983) 43 NBR (2d) 186

[6] *Cookson v. Swire* (1884) 9 App Cas 653 (HL), per Lord Blackburn

Some method of making nonpossessory security in chattels effective against third parties had to be found. In the mid nineteenth century, legislatures everywhere in the common law world finally responded with the passage of the *Bills of Sale Acts*. The effect of these *Acts* was to allow a secured party to perfect a security interest in chattels by filing or registering it in a public registry in lieu of taking possession of the chattels themselves. Public filing eliminated the problem of distinguishing between fraudulent and honest transfers by providing a clear cut means of evidencing the antecedent nature of the transaction. It also met the problem of reliance on ostensible ownership by providing prospective purchasers and mortgagees of the collateral with a means of searching for prior transfers.

In New Brunswick, the first *Bills of Sale Act* was enacted in 1874[7]. Under section 1, unless possession of the subject chattels was transferred, every bill of sale, whether absolute or conditional, had to be publicly filed and took effect, as against subsequent purchasers and mortgagees and as against the transferor's execution creditors generally, only from the time of filing. While there have been countless amendments made to the original *Act* in the intervening one hundred and seventeen years, today's version is based on the same fundamental rule.

Conditional Sales.

As other forms of nonpossessory security in chattels came into popular commercial use, legislatures in North America responded by making public registration a condition of perfected status as against third parties.

The conditional sale, still a hugely popular form of sales financing, first began to be used in commerce in North America in the 1860's and legislation regulating its registration began to be enacted from 1882 onwards[8].

In 1922, the Uniformity Commissioners of Canada adopted a *Uniform Conditional Sales Act*. Adopted by most Canadian provinces, the 1922 uniform *Act* departed from the *Bills of Sale Act* model in an important respect. Under the *Bills of Sale Act*, an unregistered chattel mortgage was ineffective against all creditors of the debtor, regardless of when they acquired their status. But under the 1922 version of the *Uniform Conditional Sales Act*, only those creditors who acquired their status subsequent to the making of the original sale were protected. The only conceivable basis for a distinction along these lines is that the evidentiary difficulty in distinguishing between honest and fraudulent secret transfers that arises in the case of chattel mortgages does not present itself so acutely in the case of a conditional sale where the ownership of the collateral originates with the secured party rather than with the debtor.

However, by this stage in the evolution of chattel security law, registration had begun to acquire yet a third function, at least in North American commercial and insolvency law if not in English law: as an ordering mechanism for demarcating when a secured party had acquired rights in the collateral sufficient to defeat the rights of unsecured creditors. Such an ordering principle was needed because of yet another important distinction between North American and English law - the legislative rule by which all creditors are entitled to share ratably in the fruits of execution, a rule which in Canada replaced the English race to the quick principle, both under the federal *Bankruptcy Act* and under the provincial *Creditors' Relief Acts*[9]. This rule rendered untenable any basis for distinguishing between the rights of unsecured creditors as against an unperfected security interest depending on when they acquired their status since the prior creditors would ultimately be entitled to share ratably with the subsequent creditors in the proceeds of execution against the collateral in any event.

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[7] *An Act to Prevent Frauds on Creditors by Secret Bills of Sale*, 37 Victoria 1874, c. 14, passed 8 April 1874 to take force the 1st October next.

[8] See Jacob Ziegel, *Uniformity of Legislation in Canada: The Conditional Sales Experience* (1961) 36 Can Bar Rev 165; and see Ziegel, Geva and Cuming, *Commercial and Consumer Transactions: Cases, Text and Materials*, revised 2d ed., 1990, at p. 962-3.

The problem was finally rectified in 1947 when the Uniformity Commissioners adopted a revised uniform *Conditional Sales Act*. The revised Act, which is the model for the present New Brunswick *Conditional Sales Act*, did away with any distinction between prior and subsequent creditors, making registration a requirement for effectiveness against both classes of interests[10].

Assignments of Book Debts

The perfection requirements for assignments of debts and other choses in action have evolved along a rather more torturous path. It is of course inherently impossible to effect a physical transfer of this form of intangible collateral. Nor is a constructive transfer of possession possible as it is for negotiable instruments where a physical transfer of the instrument can be and is treated as an effective transfer of the underlying claim. How then was it possible to sufficiently "publicize" an assignment of a debt so as to alert later assignees that the subject matter of their assignment had already been transferred to another?

The early English common law struck upon notification of the assignment to the account debtor as the closest functional equivalent to a physical transfer of possession. This notion found expression in the so-called rule in *Dearle v. Hall*[11]. Under this rule, priority between assignees of the same debt is determined by the order in which they notify the account debtor of their assignments unless the first-notifying assignee knew about an earlier assignment when he or she took his own. Though expressed as a rule of priority, the principle of publicity or perfection is the most widely-accepted rationale for subordinating the non-notifying assignee under *Dearle v. Hall*: in the absence of notification, prospective subsequent assignees are unable to "search" for prior assignments by enquiry of the account debtors[12].

At common law, the publicity requirement was originally less pervasive in relation to intangible collateral than for chattels. This is because English and Canadian common law never extended the doctrine that lack of possession constitutes a "badge of fraud" from chattel transfers to assignments so as to make notification a condition of perfection against the debtor's unsecured creditors. Consequently, the rule in *Dearle v. Hall* is and was always restricted to a priority contest between successive assignees. As between an assignee competing with a garnishing creditor, the garnishor could not claim priority simply because it had served its garnishing order on the account debtor before the assignee has given notice of the assignment[13].

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[9] See further the commentary on section 20.

[10] *cf.Borg-Warner v. Bank of Montreal* (1982) 43 NBR 2d 186 (NBCA) and case comment by Walsh, (1983) 43 NBR 2d 186.

[11] (1828) 3 Russ 1

[12] *In Re Maritime Radio Corpn. Ltd.* (1927) 8 CBR 153 (NBSC). And see generally Johnson, "Accounts Receivable Financing in Canada: Nature of the Charge and Rights of Priority" (1981) 15 UBC Law Rev 87-152.

However, the common law's exclusion of judgment creditors from the benefits of the perfection requirement was incompatible with the emerging North American view of perfection as a means of determining priority as between secured and unsecured creditors. Accordingly, in 1919, the Canadian *Bankruptcy Act* was amended to allow a trustee in bankruptcy to avoid any general assignment of book debts that had not been registered. Provincial legislatures throughout common law Canada were thus forced to supply a registration regime for assignments of accounts. The result was the *Assignment of Book Debts Acts*. Under these Acts, enacted in all of the common law provinces including New Brunswick, failure to register a general assignment of debts rendered the assignment void as against subsequent purchasers and mortgagees of the book debts as well as the debtor's execution creditors.

The establishment of registration systems for assignments of book debts ought in theory to have dispensed with the need to notify the account debtors in order to perfect a security interest against subsequent assignees. Some of the provincial Acts made this explicit. New Brunswick left the issue to common law development and Canadian courts have generally refused, at least until recently, to treat registration of an assignment as constituting notice of it to subsequent assignees for the purposes of the rule in *Dearle v. Hall*[14]. Consequently, even a prior-executed and prior-registered assignment is vulnerable to subordination to a subsequent assignment if the first-registering assignee fails to give notice to the account debtors ahead of the subsequent assignee.

Corporate Secured Debt Instruments.

In 1931 the Uniformity Commissioners of Canada proposed a Uniform *Corporation Securities Registration Act*. Adopted throughout common law Canada, including New Brunswick, the *CSRA* represents the first legislative recognition of the deficiencies of an *ad hoc* approach to the registration of personal property security interests and the first legislative attempt at a more comprehensive regulatory regime in better tune with modern commercial reality.

In the first place, the CSRA registry was set up on a province-wide basis so as to allow one-stop shopping for corporate debt security whereas the *BSA*, *CSA* and *ABDA* registry systems had all been established on a county or district basis in most provinces, including New Brunswick, a feature which made the process of registration and searching an onerous one.

Secondly, the *CSRA* permitted a single document and a single registration to cover security interests taken in both book debts and chattels whereas the ABDA and the BSA had been set up separately from each other so that a separate security agreement and separate registration was needed to perfect an interest against each type of collateral.

(continued)

[13] *Alta. Paper Co. v. Metro Graphics Ltd.* (1983) 49 CBR (NS) 63 (Alta QB), *Color Craft Litho Inc. v. Maxco Management Ltd.* (1984) 54 BCLR 121 (BCCA). For the same reason, the rule has no application to subsequent statutory assignees such as trustees and assignees in bankruptcy: *In re Maritime Radio Corporation* (1927) 8 CBR (NS) 153 (NBSC). But note that in the case of a general assignment of book debts, any arrangement under which the debtor remains free to collect in and deal with the book debts in the ordinary course of business runs the risk of being classified as a floating charge. If so classified, the debts will be vulnerable to garnishment until the secured party intervenes to crystallize the charge on default.

[14] *Snyder's Ltd v. Furniture Finance Corporation Ltd* 66 DLR 79, at 86; [1931] 2 DLR 398 per Orde J.; *In re Maritime Radio Corporation* (1927) 8 CNR 153 (NBSC); *Toronto Dominion Bank v. Mercury Express* (1979) 27 CBR (NS) 310 (BCSC); *Harding Carpets Limited v. Royal Bank of Canada* [1980] 4 WWR 149 (Man QB)

But in its basic philosophy, the *CSRA* states the same fundamental principle as the other three registry statutes. Failure to register a corporate debenture charging book debts or chattels as security renders the security interest void as against subsequent purchasers and subsequent mortgagees of the collateral and as against the debtors' general creditors and trustee in bankruptcy.

Perfection under the PPSA

Under PPSA section 19, a security interest is perfected when it has attached[15] and all steps necessary for perfection have been carried out. As a general rule, secured parties have the same choice of perfecting steps under the PPSA that they do under the existing law: they can publicize their security interest either by registration[16] or by taking possession of the collateral (provided the collateral is of a type capable of being reduced into possession)[17]. However, the PPSA eliminates the supplementary perfection methods recognized by the existing law, including the antiquated rule in *Dearle v. Hall* discussed above as well as the idiosyncratic concept of manufacturers' notice under the *Conditional Sales Act* under which a conditional seller who is a manufacturer with an office in the province can escape the registration burden by affixing its name to the goods.

In a few exceptional situations, the PPSA permits a security interest to be perfected for a temporary period without either possession or registration[18]. However, since temporary perfection necessarily means that the security interest is not publicized, buyers and lessees who take their interest during the temporary perfection period take free of the security interest[19].

Under the existing law, a security interest cannot be perfected by registration unless and until it comes into existence. This is because the existing registration statutes require registration of a copy of the actual security agreement executed between the parties. The PPSA registry system requires only that notice of the security interest be registered. This in turn permits a security interest to be publicized in advance of its coming into existence[20]. Accordingly, PPSA section 19 makes it clear that a security interest will be perfected regardless of whether the secured party performs its act of public notice, be it registration or taking possession, before or after the security interest attaches.

As against unsecured creditors and their representatives, the effect of failing to perfect is similar (if somewhat more refined) under the PPSA to what it is under the existing law. In both cases, the security interest will be ineffective so long as it remains unregistered or otherwise unperfected[21].

The same is true where the competing interest is that of a subsequent transferee of the collateral other than a subsequent secured party. Under both the existing law and the PPSA, the unperfected interest will be subordinate to the interest of a subsequent transferee who gives value and acquires the interest without knowledge of the prior unperfected security interest[22].

But where the priority contest is between a perfected and an unperfected security interest, the PPSA approach differs somewhat from that taken under the existing law.

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[15] See section 12.

[16] See section 25.

[17] See section 24

[18] See sections 5(2), 7(3), 26, 28(3), 29(4) and 51.

[19] See section 30(5)

[20] See further section 43.

[21] See section 20.

[22] See PPSA section 20.

Under the existing law, it is only subsequent secured parties who are protected against a failure to register by another secured party and then only if they acquired their interest without knowledge or notice of the unregistered interest. These qualifications are justified on the basis that it is only subsequent secured parties without notice or knowledge who could have relied on the debtor's ostensible ownership. If they advanced funds knowing of the prior interest, then priority reverts to a *nemo dat* ordering.

Under the PPSA, an unperfected security interest is subordinated against all perfected security interests in the collateral, regardless of when they arose and regardless of knowledge or notice. This does not mean that reliance is any less a justification for subordinating the unperfected interest under the PPSA than it is under the existing law. The difference is that under the PPSA, a secured party can place absolute reliance on the registry without worrying about whether it might later be held to have had knowledge of a prior unregistered security interest. This approach is a desirable one because it promotes certainty and reduces litigation on the inherently difficult question of whether somebody took with knowledge of a prior interest. It is made possible by the fact that PPSA Part 3 contains a detailed priority code under which priorities are ordered in general according to the order of registration or taking possession as the case may be[23]. This priority code is workable only if registration is accepted at face value. Finally, of course, the new approach is more compatible with contemporary views on the function of the registry as an ordering mechanism for determining rights among creditors, both secured and unsecured.

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[23] See section 35.

NOTES

SECTION 20

SUBORDINATION OF UNPERFECTED SECURITY INTERESTS TO EXECUTION CREDITORS, TRUSTEE IN BANKRUPTCY AND TRANSFEREES OF THE COLLATERAL

20(1) A security interest

(a) in collateral is subordinate to the interest of

(i) a person who causes the collateral to be seized under legal process to enforce a judgment including execution, attachment or garnishment or who obtains a charging order or equitable execution affecting or relating to the collateral,

(ii) a sheriff who has seized or has a right to the collateral under the *Memorials and Executions Act*,

(iii) a creditor entitled by law to participate in the distribution of property or its proceeds seized under legal process as provided in the *Creditors' Relief Act*, and

(iv) a representative of creditors but only for the purposes of enforcing the rights of a person referred to in subparagraph (i)

if that security interest in unperfected at the time

(v) the interest of the person mentioned in subparagraph (i), (ii) or (iv) arises or

(vi) the creditor mentioned in subparagraph (iii) delivers an order for seizure or certificate to the sheriff under the *Creditors' Relief Act*,

(b) in collateral is not effective against

(i) a trustee in bankruptcy if the security interest is unperfected at the date of bankruptcy, or

(ii) a liquidator appointed under the *Winding-up Act* (Canada) if the security interest is unperfected at the date the winding-up order is made;

(c) in goods, chattel paper, a security, a negotiable document of title, an instrument, an intangible or money is subordinate to the interest of a transferee who

(i) acquires the interest under a transaction that is not a security agreement,

(ii) gives value, and

(iii) acquires the interest without knowledge of the security interest and before the security interest is perfected.

20(2) Collateral is seized through garnishment within the meaning of subsection (l)(a)(i) when a garnishee summons binds the collateral.

COMMENTARY

Purpose

Under the personal property registration statutes currently in effect in New Brunswick, an unregistered security agreement is deemed to be "void" against subsequent purchasers and mortgagees of the collateral and against unsecured creditors and their representatives including a trustee in bankruptcy[1]. Under the PPSA, priority as between an unperfected security interest and subsequent security interests in the same collateral is dealt with in section 35 of the Act while section 20 addresses the priority effect of non perfection against subsequent transferees and the debtor's unsecured creditors and their representatives[2].

Subordination of an Unperfected Security Interest to the Debtor's Unsecured Creditors - Existing New Brunswick Law

By definition, a simple contract creditor has no real claim against any specific assets of her debtor. But once an unsecured creditor sues to judgment and initiates execution, her personal rights against the debtor can ripen into *real* rights against the debtor's exigible personalty capable of binding third party transferees.

Once a debtor's assets are bound in execution, the potential exists for a priority conflict between the unsecured creditor and a secured party holding a security interest in the same debtor's assets. On a strict application of the common law maxim "*nemo dat quod non habet*", the priority issue would resolve itself according to when the security interest attached. If before execution bound the assets, then the secured party would take priority. If after, then the unsecured creditor would take priority.

But common law legal systems have long taken the view that the debtor's unsecured creditors should be protected against a prior "secret" transfer of the debtor's assets in which the debtor remains in possession and apparent ownership[3]. This attitude is reflected in the current registration statutes which effectively postpone the time for resolving priority from attachment to perfection. Under the *Bills of Sale Act*, the *Corporation Securities Registration Act* and the *Assignment of Book Debts Act*, a security agreement is deemed void against creditors until registered *and* takes effect as against creditors only upon registration. Accordingly, collateral subject to an attached security interest remains vulnerable to being bound in execution at the instance of the debtor's unsecured creditors until it is registered.

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[1] See the commentary on section 19.

[2] Section 20(1)(a)(i) of the new Ontario PPSA provides that until perfected a security interest in collateral is subordinate to the interest of a person who has a perfected security interest in the same collateral. In the Western Model, it is section 35 which deals with priority between perfected and unperfected security interests.

[3] See the commentary on section 19.

The sole exception is the *Conditional Sales Act* which provides the secured party with a grace period for registration[4]. Unlike the other three registration statutes, a conditional sale takes immediate effect against creditors and other third parties (except bona fides purchasers) provided the sale is evidenced by a written agreement signed before or within ten days after delivery of the goods by the buyer and provided the agreement is registered within thirty days of its execution. So long as these time periods are respected, the conditional vendor will retain its common law priority against intervening execution creditors.

Subordination of an Unperfected Security Interest to the Debtor's Unsecured Creditors under the PPSA

As under the existing registration statutes, the PPSA subordinate an unperfected security interest to the interest of the debtor's unsecured creditors. Unlike the existing Acts, however, the PPSA does not leave it to the law of executions to determine at what point in the execution process an unsecured creditor acquires sufficient *real* rights against the debtor's collateral to defeat a subsequent attempt at perfection by the secured party.

Under section 20 of the new Ontario PPSA, an unperfected security interest is subordinated to "a person who *assumes control of the collateral* through execution, attachment, garnishment, charging order, equitable execution or other legal process". What constitutes assuming control of the collateral is not defined but it seems that the control required is full control - seizure - and not merely steps leading up to the assumption of control.

To remove any doubt on the subject, section 20 of the Western Model PPSA proposed for New Brunswick expressly subordinates an unperfected security interest to the interest of "a person who causes the collateral to be seized under legal process to enforce a judgment including execution, attachment or garnishment or who obtains a charging order or equitable execution affecting or relating to the collateral".

The sole exception to subordination on seizure is a fifteen day grace period for perfection given to PMSI's by section 22 of the PPSA. Consistently with the superpriority accorded to purchase money security interests as against other security interests, a PMSI holder is given a fifteen day period in which to effect perfection as against creditors or a bankruptcy trustee. During this grace period, the security interest will remain effective against any intervening seizure or bankruptcy. This special protection is essentially a continuation of the existing *Conditional Sales Act* policy under which, as noted above, a conditional seller's security interest takes effect immediately on sale as against creditors so long as the time periods for execution of a security agreement and its filing in the conditional sales registry are respected.

When are a Debtor's Assets Bound in Execution under Debtor & Creditor Law?

Under existing New Brunswick executions law, the point in the execution process at which the debtor's assets are bound depends on the nature of the personalty. In the case of goods, delivery of the writ of execution (now order for seizure and sale) by the execution creditor to the sheriff binds the goods against subsequent transferees. In the case of execution against a debt or other chose by way of garnishment, it is service of the garnishee summons (now attaching order) on the garnishee that binds the debt. For all other forms of exigible personalty, seizure of the collateral is necessary.

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[4] See further the commentary on section 22.

Resolving conflicts between the PPSA and Executions Law

With two exceptions, the choice of seizure in PPSA section 20(1)(a) as the relevant point in the execution process at which an execution creditor achieves priority over an unperfected security interest is compatible with the rules of executions law on when the debtor's assets are to be considered bound in the execution process. But there are two potential areas of conflict.

The first concerns the meaning of "seizure" in the context of garnishment. Under executions law, a debt is considered bound against subsequent assignees as soon as the attaching order or garnishee summons is served on the garnishee and not upon payment to the judgment creditor or into court. To ensure compatibility between the PPSA and executions law on this point, PPSA section 20(2) makes it clear that in the case of garnishment, the property is to be considered seized for the purposes of section 20 when a garnishee summon binds the collateral.

The second potential area of conflict concerns execution against goods. Under executions law, it is delivery of the writ of execution to the sheriff rather than the subsequent seizure that binds the goods against subsequent third party claimants. There will be no conflict between this rule and the seizure rule in PPSA section 20(1)(a) so long as the security interest attaches *before* the writ is delivered to the sheriff. Even though at common law the binding effect of the writ would be subject to the prior security interest, the effect of section 20 is to make attachment ineffective against the unsecured creditor who manages to effect seizure before the security interest is perfected.

But what happens if the security interest does not attach until after the writ is delivered to the sheriff? Does the fact that under executions law delivery of the writ binds the debtor's goods against subsequent transferees mean that a subsequent security interest will be subordinated to the execution creditor notwithstanding that the security interest is registered before actual seizure under execution is made?

The problem of the binding effect of the writ is dealt with differently in different PPSA jurisdictions.

British Columbia executions law already contained independent protection for *bona fides* transferees of goods bound in execution if they had no notice that the writ had been delivered to the sheriff. Accordingly, under British Columbia law, a secured party who takes its interest subsequent to delivery of the writ to the sheriff will retain priority over an execution creditor provided it perfects before the goods are actually seized in execution and provided it took without knowledge of the security interest.

Saskatchewan's solution was to amend its *Executions Act* to permit execution creditors to "perfect" their writs by registration in the PPSA registry after delivery to the sheriff with priority between the execution creditor and secured parties then determined by a first to register rule. This amendment effectively gives execution creditors two means of gaining priority over a competing security interest in goods - either seizure or registration.

Alberta has likewise amended its *Executions Act* to permit an execution creditor to maintain the binding effect of its writ as against bona fides transferees and subsequent secured parties through registration in the PPSA registry. So long as the writ is registered before the subsequent disposition or attachment, the writ holder will take priority notwithstanding that the goods are not seized at the point at which the security interest is registered. Unlike the Saskatchewan approach, however, the priority accorded a registered writ operates only as against security interests that do not attach until after registration. As against prior security interests, seizure remains necessary in order for the execution creditor to come ahead of the subsequent creditor.

Proposed Reforms of the Law of Executions in New Brunswick.

The Williamson report on the reform of debtor creditor law in New Brunswick recommended the establishment of a unified province wide system for the enforcement of judgments. Under the proposed system, all judgment creditors would be required to deliver a Notice of Enforcement to a District Enforcement Office. The Notice of Enforcement would be filed in a new computerized central registry to be consolidated with the PPSA registry if and when one was implemented. The current doctrines on when assets are to be considered bound in execution would be abolished. On filing, the notice would bind all exigible non-exempt personal property of the judgment debtor in the province. A filing would be effective for three years and renewable for further periods of three years.

If the Williamson recommendations are adopted, section 20 of the New Brunswick PPSA should be modified to eliminate seizure as the relevant event for determining priority between an execution creditor and a PPSA security interest. The new provision would instead provide that an unperfected security interest is subordinated to the interest of a judgment creditor who has obtained a Notice of Enforcement if the security interest is unperfected at the time the Notice of Enforcement is registered in the PPSA registry pursuant to the new *Executions Act*.

If the Williamson recommendations are not adopted by the time the PPSA comes into force, then the *Memorial and Executions Act* should at least be amended along the same lines as in Saskatchewan so as to permit registration of an order for seizure and sale in the Personal Property Registry to maintain the binding effect of the order as against subsequent transferees.

Integration of Distribution Scheme under the Creditors' Relief Act with the PPSA

If an execution creditor succeeds in seizing the debtor's goods prior to registration of a security agreement covering the goods, the quantum of its judgment plus costs will determine the quantum of the priority enjoyed by the unsecured creditor over the secured party. This does not mean, however, that the execution creditor will get to enjoy the fruits of its victory exclusively. True, at common law, the first judgment creditor to bind the property of the debtor was entitled to be paid in full ahead of the debtor's other creditors. But in company with other common law provinces, New Brunswick has abolished the common law policy of first come first served, replacing it with a scheme of ratable distribution amongst all unsecured creditors similar to that policy which obtains in bankruptcy. These acts were first passed to fill the gap that was left when the Canadian bankruptcy legislation was repealed in 1880 but were retained after the federal *Bankruptcy Act* was reinstituted in 1919.

Under the *Creditor's Relief Act*, the execution creditor must share the fruits of execution with all unsecured creditors including the debtor's simple contract creditors if they place a certificate in the hands of the sheriff within thirty days of the levy. This policy of executions law is integrated with the PPSA by section 20(1)(iii) which subordinates the unperfected security interest to all unsecured creditors entitled to share under the *Creditors' Relief Act* if the security interest is still unperfected when they deliver their execution order or certificate to the sheriff.

The Williamson report reviewed the rationales for the policy of ratable sharing, concluding that is should be retained in a modified form. Under the present scheme, the right to share is triggered only as a consequence of a levy by a sheriff under an execution. Under this wording, it is questionable whether the proceeds of garnishment are caught by the policy and the practice at present is to distribute such proceeds on a first come first served basis. So too for the proceeds of an equitable execution for installment order payments. Williamson's revised system would require ratable distribution of the proceeds of all forms of enforcement but entitlement to share would be limited to judgment creditors who had filed a notice of enforcement at the time the proceeds arose. At present, simple contract (non judgment creditors) are entitled to share if they file a certificate within thirty days of levy. The new system would limit entitlement to share to judgment creditors but would allow a grace period to enable those creditors who had commenced their action before the proceeds of execution were realized to obtain a judgment so as to qualify for a share in the distribution.

Ineffectiveness of an Unperfected Security Interest against the Trustee in Bankruptcy

Bankruptcy vests the debtor's assets in the trustee who ordinarily takes the estate subject to any equities or rights which could be enforced against the bankrupt. But a trustee in bankruptcy also acts as a representative of the bankrupt's creditors whose own enforcement rights are terminated on the bankruptcy. As representative of the bankrupt's creditors, the trustee may exercise any right they may have to impeach transactions entered into by the bankrupt. Under the existing law, this includes the right of the debtor's creditors to have an unregistered security agreement declared void. The power of the trustee in this respect is expressly recognized in the existing registration statutes which define the class of "creditors" against which an unregistered agreement is void to include a trustee under the *Bankruptcy Act* for the purpose of enforcing their rights under the acts.

Unlike the existing registration statutes, section 20(1)(b) of the PPSA gives the debtor's trustee in bankruptcy an independent priority over the holder of an unperfected security interest[5]. That is to say, the trustee does not merely succeed to the priority rights of the debtor's unsecured creditors but enjoys a separate and distinct priority status. The reason for this difference in approach lies in the fact that "creditors" are defined in the existing registration statutes to include all creditors of the debtor, whether execution creditors or not, who acquire that status before the security agreement is registered. Accordingly, so long as there is even one simple contract creditor in existence at the date of bankruptcy, an unregistered security agreement will be void as against the trustee. In contrast, the PPSA subordinates an unperfected security interest only to creditors who have actually reached the point of seizure in the execution process. If the trustee were limited to exercising their rights, then there would have to have been seizure pursuant to execution at the date of bankruptcy in order for the trustee to be able to take the benefit of the unperfected status as representative of all unsecured creditors.

The priority of the trustee over an unperfected security interest depends on whether the security interest is still unperfected at the date of bankruptcy. Under bankruptcy law, when a bankruptcy takes effect depends on whether the bankruptcy is voluntary or involuntary. If by way of a voluntary assignment, it takes effect at the time that the assignment papers are stamped as filed with the local office of the Official Receiver. If the bankruptcy is involuntary, the trustee's status will relate back to the date of filing of the petition in bankruptcy that eventually resulted in a Receiving Order[6].

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[5] Under the previous Ontario PPSA, the bankruptcy trustee had to establish - by filing an affidavit - that at least one unsecured creditor was without knowledge of the unperfected security interest at the date of the bankruptcy. The new Act deletes this artificial and theoretically indefensible requirement.

[6] Where registration follows the date or in close situations the hour of the bankruptcy petition then the security interest will be subordinated even if it was signed prior to the date

Subordination of an Unperfected Security Interest to Bona fides Transferees of the Collateral[7]

Under the common law maxim *nemo dat quod non habet*, a transferee of property takes subject to any existing third party proprietary interests. Over the years, however, common law jurisdictions have developed a wide variety of exceptions to the *nemo dat maxim* designed to protect purchasers for value in circumstances where they cannot verify the transferor's title or should not reasonably have to do so in the circumstances. The most ubiquitous of these inroads on the *nemo dat* maxim in existing law is found in the registration statutes governing personal property security, all four of which void an unregistered security interest as against, *inter alia*, subsequent purchasers of the collateral for value without notice.

The same policy is maintained in section 20(1)(c) of the PPSA under which an unperfected security interest will be subordinated *inter alia* to the interest of a transferee for value who takes without knowledge of the security interest before it is perfected.

(continued)
of the petition: *Re Hillstead* (1979) 26 OR 2d 289

[7] Section 20(1)(a)(i) of the new Ontario PPSA also subordinates an unperfected security interest in collateral to a person who has a lien given under any other Act or by a rule of law or who has a priority under any other Act. Section 20(2)(a)(ii) then deals with when the rights of a person with a statutory lien "crystallize" such that any attempt at perfection after the fact will be too late to escape subordination. Two events are specified: in the case of a bankruptcy, at the date of the bankruptcy and otherwise, when the lien holder has taken possession or otherwise done everything to make the lien enforceable in accordance with the provisions of the Act creating the lien. No guidance is given as to the crystallizing point for non statutory liens. With the exception of section 32, the Western model does not deal with priorities as between PPSA security interests and common law equitable or statutory liens and priorities either in section 20 or elsewhere in the PPSA. See futher the commentary on section 4(a).

NOTES

SECTION 21

DAMAGES RECOVERABLE BY LESSOR OR CONSIGNOR

21 Where the interest of a lessor under a lease for a term of more than one year or of a consignor under a commercial consignment is subordinate to the interest of a creditor under section 20(a) or is not effective against a trustee or liquidator under section 20(b), the lessor or consignor is deemed, as against the lessee or consignee, as the case may be, to have suffered, immediately before the seizure of the leased or consigned goods or the date of the bankruptcy or winding-up order, as the case may be, damages in an amount equal to

(a) the value of the leased or consigned goods at the date of the seizure, bankruptcy or winding-up order, and

(b) the amount of the loss, other than that referred to in clause (a), resulting from the termination of the lease or consignment.

COMMENTARY

The perfection and priority rules of the PPSA apply both to true security interests[1] and certain deemed security interests including a commercial consignment and a lease for a term of more than one year.[2] In either case, a failure to perfect before execution or bankruptcy means a loss of the collateral to the debtor's execution creditor or trustee in bankruptcy, as the case may be, by operation of section 20.

In the case of a true security interest, the loss of the collateral does not affect the underlying debt and the non-perfecting party will still be entitled to assert a claim against the debtor's estate as an unsecured creditor for the balance owing under the security agreement.

But the nature and quantum of a true lessor's or consignor's claim against the debtor as an unsecured creditor is less straightforward. Had the debtor voluntarily made an unauthorized disposition of the collateral, the lessor or consignor would be entitled to claim against the debtor for: (a) the ordinary measure of damages for breach of the lease or consignment agreement, and (b) the residual value of the goods at the date of the breach. But the right to claim damages for breach where the lessee's or consignee's inability to maintain performance is caused by her intervening bankruptcy or execution will depend on whether these events are considered to be breaches in themselves. Moreover, it could be further argued that there is still no right to claim for the residual value of the collateral because the effective cause of its loss was not the bankruptcy or execution but the secured party's own failure to perfect its interest in time. Section 21 is intended to forestall any arguments along these lines and to ensure the lessor's and consignor's right to claim for their true loss on an "unsecured" basis.

Section 21 does not apply to the other two categories of deemed security interests under section 3 - an absolute transfer of an account and an absolute transfer of chattel paper - even though the transferee will also suffer a loss of the subject matter of the transfer for failure to perfect under section 20. There is reason for the difference in treatment. While a consignor or lessor clearly holds the residual value in the goods, the same cannot be said where there is an absolute transfer of accounts or chattel paper. The question instead depends on the terms of the transfer and in particular, whether it was expressed to with or without recourse against the transferor in the event the transferee is unable to collect against the account debtor or obligor under the chattel paper. If the sale was made with recourse, then the assignee will automatically qualify as an contract creditor against the debtor's estate. If the sale is one without recourse, then the assignee has clearly assumed the risk of being unable to collect, and has no further claim against the debtor's estate.

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[1] See section 2.
[2] See section 3.

SECTION 22

GRACE PERIOD FOR PERFECTION OF PURCHASE MONEY SECURITY INTERESTS

22(1) **A purchase-money security interest in**

(a) collateral, other than an intangible, that is perfected not later than 15 days after the day that

(i) the debtor obtains possession of the collateral, or

(ii) a third party, at the request of the debtor, obtains possession of the collateral,

whichever is the earliest, or

(b) an intangible that is perfected not later than 15 days after the day the security interest attaches

has priority over the interests of persons referred to in section 20(1)(a) and (b)

22(2) **For the purposes of this section, where goods are shipped by common carrier to a debtor or to a person designated by the debtor, the debtor does not have possession of the goods until the debtor or the third person, at the request of the debtor, has obtained actual possession of the goods or a document of title to the goods, whichever is earlier.**

COMMENTARY

Grace Period for Perfection of Conditional Sales Agreements under the Existing Law

All four of the existing New Brunswick registration statutes purport to allow a secured party a "grace period" of thirty days to register the security agreement after it is executed. However, three out of four of these statutes also provide that the security agreement does not take effect against third parties, including the debtor's unsecured creditors and their representatives, until it is actually registered. This qualification effectively renders the provision of a grace period illusory. The exception is the *Conditional Sales Act*. A conditional sale becomes effective against the debtor's creditors and their representatives immediately it is entered into provided it is evidenced by a writing signed by the buyer within ten days of delivery of the goods and the writing is registered within thirty days of the signing. So long as these time periods are respected, the conditional seller retains its common law priority should execution or bankruptcy intervene in the period between execution of the security agreement and its ultimate registration.

Grace Period for Perfection of PMSI's under the PPSA

Section 22 of the PPSA is intended to provide a similar kind of interim protection not only for conditional sellers but for purchase money security interests in general. Under section 22, the PMSI-holder is given a grace period of 15 days from the time possession of the collateral is delivered to perfect its security interest. So long as the PMSI is perfected within the prescribed period, it escapes subordination under section 20[1]. The special status of purchase money security interests is also reflected in section 34 of the Act which awards a super priority to a purchase money security interest in collateral over any other security interest in the same collateral, whether previously or subsequently perfected.

To gain the protection of the grace period, the PMSI-holder must perfect not later than 15 days after the debtor, or a third party at the request of the debtor, obtains possession of the collateral, whichever is the earlier. If the section merely required perfection within fifteen days of the debtor obtaining possession, the secured party would have a potentially infinite time to perfect in a case where the debtor, as often happens, requested that goods be delivered to some other person or location. In any event, whoever is the recipient of the collateral, it is essential that accurate proof of the time when possession was transferred be obtained and maintained to ensure proof against subordination under section 20.

The grace period applies to PMSI's in all types of collateral, including intangibles. However, where the collateral takes the form of an intangible, it is impossible to take physical possession of it. Accordingly, section 22(1)(b) substitutes the concept of attachment for obtaining possession as the relevant event from which the grace period for perfection commences to run.

Proposed Amendment to Western Model PPSA

While this is undoubtedly the intent, the Western Model PPSA does not expressly state that the debtor's possession must be *qua* debtor and not in some other capacity before the grace period will commence to run. A proposal will be made to the Canadian Conference on Personal Property Security Law to amend section 22(a)(i) to add the words "as a debtor" in order so as to ensure that a seller who relinquishes possession of goods to a prospective buyer for a "trial" period does not inadvertently initiate the commencement of the grace period before the buyer has actually made the decision to purchase and changed its status to a PMSI debtor.

Subordination of Unperfected PMSI to Intervening Transferees

The grace period for registration afforded conditional sellers under the existing law does not apply in the case of an intervening sale of the collateral to a bona fides purchaser of the collateral for value without notice. Both the *Sale of Goods Act* and the *Factors and Agents Act* give a buyer in possession of goods under a conditional sales agreement the power to convey good title to an ordinary course transferee who takes *bona fide* and without notice[2]. While these statutes have been amended to provide that registration of a conditional sale under the *Conditional Sales Act* constitutes automatic notice to a *bona fides* purchaser[3], the notice operates only from the point of registration forward. Accordingly, a sale or other disposition made in the course of the grace period and before registration will be effective against the conditional seller.

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[1] The old Ontario PPSA inadvertently protected a PMSI so long as it was registered within the grace period even though it was not perfected within that period so as to otherwise give it super priority status. Under the new wording, PMSI's that are unperfected at the relevant priority point under section 20 will lose out to the interests mentioned therein unless they are registered and registered so as to be perfected. The change means that *Gooderham v UOP Ltd* 5 PPSAC 58 following *Re Peelee Motor Inn* (1978) 18 OR 2d 700 affirmed without reasons by the Ontario Court of Appeal, 28 CBR (NS) 224 no longer applies.

The PPSA adopts the same protective policy. The 15 grace period for perfection given by section 22 is effective only against the third party interests named in section 20(a) and (b) - i.e., execution creditors and the trustee in bankruptcy. As against the third party interest mentioned in section 20(c) - i.e., a transferee of the collateral for value without notice - section 20 remains operative and the security interest will be subordinated if the transfer takes place before the PMSI is perfected[4]. This policy is consistent with other sections of the PPSA which likewise protect intervening transferees without notice against any prejudice caused by the lack of publicity that is inherent in the very concept of a grace period for perfection. A similar protection is also afforded to intervening transferees against the consequences of permitting temporary perfection which, like a grace period for perfection, mean that a third party is unable to search for an outstanding interest[5]. While it may be fair enough to expect the debtor's creditors to take this risk - they are both commercially knowledgeable and themselves benefit from the system - buyers and lessees who pay absolute value for collateral or its use should be entitled to absolutely rely on the integrity of a search result when it discloses no outstanding interest in the subject asset.

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[2] *Factors and Agents Act*, section 12, *Sale of Goods Act*, section 24(2).

[3] *Factors and Agents Act*, section 12.1(3), *Sale of Goods Act*, section 24(6). These amendments were brought in as a consequence of the decision of the New Brunswick Court of Appeal in *GMAC v. Hubbard* (1978) 21 NBR (2d) 49, 87 DLR (3d) 39, where it was held that a bona fide purchaser of goods subject to a duly registered conditional sales contract took free of the seller's reservation of title by virtue of the *Factors and Agents Act* and *Sale of Goods Act* provisions. However, the actual result in both these case would be no different even after the amendment because the conditional vendor had registered its interest after the buyer's disposition of the goods to the plaintiff (though within the grace period limited by the *Conditional Sales Act* for filing).

[4] The new Ontario PPSA provides that PMSI's perfected within the grace period will take priority over the interest of a transferee of collateral that forms all or part of a sale in bulk within the meaning of the Bulk Sales Act. This is narrower than the old provision which extended to all out of the ordinary course of business transfers whether in bulk or not. Presumably this means that a PMSI-holder can no longer claim ahead of a non-bulk transferee under section 20.

[5] See sections 5(2) and 30(5).

NOTES

SECTION 23

CONTINUITY OF PERFECTION

23(1) **If a security interest is perfected under this Act and is again perfected in some other way under this Act without an intermediate period during which it is unperfected, the security interest is continuously perfected for the purposes of this Act.**

23(2) **A transferee of a security interest has the same priority with respect to perfection of the security interest as the transferor had at the time of the transfer.**

COMMENTARY

Continuity of Perfection where Change in Method of Perfection

Under the PPSA, there are two principal methods by which a security interest may be perfected: taking possession of the collateral[1] and registration of a financing statement[2]. In the interests of commercial convenience, a secured party may also be afforded a temporary period of perfection without either registration or possession in certain exceptional circumstances. The purpose of section 23 is to enable the secured party to switch from one method of perfection to another as circumstances dictate without suffering any lapse in the continuity of its perfected status. Provided there is no intermediate period in which the security interest is unperfected, the security interest will be regarded as continuously perfected from the date of the initial perfecting step notwithstanding successive changes in the method of perfection.

Significance of Maintaining Continuity of Perfection

Under PPSA sections 35(1) and 20, an unperfected security interest is potentially subordinated to three principal categories of third party claimants: (1) other perfected security interests in the same collateral (2) transferees for value without notice and (3) the debtor's unsecured creditors and their representatives including the debtor's trustee in bankruptcy.

As against the debtor's execution creditors, trustee in bankruptcy or a transferee of the collateral without notice, a loss of continuity of perfection is not necessarily fatal *provided* the secured party reperfects before they acquire an interest in the collateral sufficient to defeat an unperfected security interest under section 20. Any attempt to reperfect after the fact, however, will generally be no more successful than if the security interest had never been perfected in the first instance.

Maintaining continuity of perfection may be critical to maintaining priority, however, when the competing third party claimant is another secured party with a perfected security interest in the same collateral. Under the general or residual rule of priority set out in section 35(1), competing security interests in the same collateral are ranked as of the date that the original perfecting step was taken. Section 35(2) complements section 23(1) and provides that for the purposes of applying section 35(1), a continuously perfected security interest is deemed to have been perfected by the method by which it was initially perfected. But should the secured party fail to maintain continuity of perfection, its pre-lapse priority ranking will be lost and its perfected status for priority purposes will date only from the point of reperfection. The sole exception to this is where the cause of lapse is a lapse in registration in which event section 35(7) gives the secured party thirty days to re-register without loss of priority status against pre-lapse interests.

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[1] Section 24

[2] Section 25

Continuity of Perfection where Transfer of Security Interest.

As under the existing registration regimes, if a registered security interest is transferred, the registration may be, but need not be, amended to disclose the transferee as the new secured party of record[3]. Nor is continuity of perfection affected by the transfer. Section 23(2) makes it clear that the transferee automatically succeeds to the same perfection and priority status enjoyed by the transferor at the time of the transfer. This makes sense. The principal search criterion is the name of the debtor, not the secured party, so a change in the secured party does not undermine the effective functioning of the registry system.

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[3] Section 45

SECTION 24

PERFECTION BY POSSESSION

24(1) **Subject to section 19, possession of the collateral by the secured party, or on the secured party's behalf by another person, pursuant to a security agreement perfects a security interest in**

(a) chattel paper,
(b) goods,
(c) an instrument
(d) a security
(e) a negotiable document of title, and
(f) money

except where possession is a result of seizure or repossession.

24(2) **For the purposes of subsection (1), a secured party does not have possession of collateral that is in the actual or apparent possession or control of the debtor or the debtor's agent.**

24(3) **Where the collateral is a security that may be transferred by an entry in the records of a clearing agency, a secured party is deemed to have taken possession of the security when the appropriate entries have been made in the records of the clearing agency.**

COMMENTARY

Generally

Under the existing New Brunswick *Bills of Sale Act*, secured parties are relieved from any obligation to register a security agreement covering chattels if they take possession of the collateral. As an act of public notice, the secured party's possession functions at least as adequately as registration to alert third parties to the secured party's potential interest in the assets[1].

The PPSA maintains this same basic policy. Under section 24, taking possession perfects a security interest in collateral. Unlike perfection by registration under section 25, however, perfection by possession under section 24 is limited to certain types of collateral: *viz.*, chattel paper, goods, an instrument, a security, a negotiable document of title and money. Thus, intangibles (including accounts) and non-negotiable documents of title are excluded. The reason why these types of collateral can only be perfected by registration is purely pragmatic. Unlike goods, chattel paper, a security or an instrument, "pure" intangibles are inherently incapable of being delivered into physical or even symbolic possession. And unlike a negotiable document of title, transfer of a non-negotiable document of title does not transfer title to the goods it represents. As to perfection of a security interest in the goods represented by either a negotiable or non-negotiable document of title, see further section 27.

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[1] See further the commentary on section 19.

Section 24 is "subject to section 19"; that is to say, taking possession of the collateral will perfect a security interest only once the security interest has attached within the meaning of section 12. It will be recalled that section 12 establishes three prerequisites for attachment: (1) value is given; (2) the debtor has rights in the collateral; and (3) for the purposes of attachment against third parties, fulfillment of the section 10 evidentiary requirement that the secured party either take possession of the collateral or satisfy the writing requirement. Accordingly, taking possession for the purposes of perfection pursuant to section 24 will simultaneously fulfill the third requirement for attachment under section 12.

Both at common law and under the PPSA, a secured party in possession of property is subject to certain rights and liabilities as bailee: see section 17.

Under section 24, possession may be taken by either the secured party or by a third party on the secured party's behalf. As to perfection of a security interest in goods in the possession of a third party bailee, see further section 27.

Inadequacy of Possession by Debtor

At common law, delivery of possession of the collateral to the secured party is an essential constituent of a pledge. But possession may be either actual or constructive and possession by the pledgor under an agreement that her custody is the custody of the secured party will suffice to complete the pledge as between the parties. On much the same theory, possession of the collateral may be returned to the debtor for some limited and defined purpose without destroying the pledge.

But what constitutes sufficient possession for perfection purposes is something else altogether. Under the existing registration legislation, only an actual and not merely a constructive or symbolic change of possession of pledged chattels is regarded as a sufficient alternative to perfection by registration. Otherwise, the whole object of requiring perfection - to afford public notice of the existence of the security interest - would be completely undermined. Thus, the *Bills of Sale Act* requires an "actual and continued change of possession" and, to put the matter beyond all doubt, further defines "change of possession" to mean "such change of possession as is open and reasonably sufficient to afford public notice thereof". This same basic policy is carried over to the PPSA. Under section 24(2), a secured party does not have possession for perfection purposes if the collateral is in the actual or apparent possession or control of the debtor or debtor's agent. In such a case, registration remains a necessity save for the highly exceptional instances listed in section 26 in which a security interest will remain temporarily perfected notwithstanding that possession of the collateral is returned to the debtor: see further the commentary on that section.

Inadequacy of Possession as a Result of Seizure or Repossession

Under the existing registration statutes, failure to register a nonpossessory security interest renders it void as against the debtor's unsecured creditors and their representatives as well as subsequent purchasers and mortgagees of the collateral. It was initially thought, however, that a secured party could cure an omission to register if it were able to realize on the collateral before third parties had voiced a complaint. This, at any rate, had been the position taken by the Ontario Court of Appeal in *Re Shelly Films Ltd.*[2] where the Court ruled that an unregistered chattel mortgage, despite the literal wording of the *Bills of Sale Act*, was voidable rather than void as against the debtor's unsecured creditors. Unless the unsecured creditors took steps to avoid the unregistered security before the secured party had gone into possession and realized on the assets, their rights were spent.

But *Re Shelly Films* was never fully endorsed by the courts in other provinces and, indeed, was in direct contradiction to the apparent intent of section 15 of the New Brunswick *Bills of Sale Act*[3]. In 1984, it was finally overruled by the Supreme Court of Canada. In *Royal Bank of Canada v. First Pioneer Investments*[4], Wilson J held that the holder of an unregistered debenture could not enforce its security interest as against the debtor's unsecured creditors by taking possession and selling the collateral before they had a chance to intervene. As against them, its security interest was void *ab initio* pursuant to the CSRA and its status thereby reduced to an ordinary contract creditor. Accordingly, all of the debtor's unsecured creditors were entitled to share ratably in the proceeds of sale of the collateral. In Wilson J's view, to uphold *Re Shelly Films* would undermine the integrity of the registry system as a means of public notice by permitting non-complying secured creditors to escape the consequences of a failure to register.

The same issue that was resolved by the Supreme Court in *Pioneer Investments* in the non-PPSA context arises anew in this way under the PPSA. Under section 20, an unperfected security interest is subordinated to a variety of third party claimants including the debtor's execution creditors and trustee in bankruptcy. Can a secured party who fails to register a nonpossessory security interest claim that a subsequent possession of the collateral for the purposes of realization constitutes perfection by possession within the meaning of section 24? If so, the collateral (or the proceeds realized on its sale) will be immunized from seizure by the debtor's execution creditors or the debtor's trustee in bankruptcy notwithstanding the secured party's failure to comply with the perfection requirements of the Act either initially or during the currency of the financing arrangement.

Earlier versions of the PPSA fail to clarify whether a subsequent taking of possession of the collateral by reason of default can be treated as perfection by possession. Judicial reaction on the issue has been divided. The Saskatchewan and Manitoba position that it cannot is based on the express wording in these Acts that possession only perfects a security interest in collateral "while it is actually held as collateral"[5]. It is argued that these words mean that the secured party's possession must be for the purposes of securing payment or performance of the debtor's obligation whereas possession as a result of repossession and seizure is aimed at terminating the financing arrangement and realizing on the collateral. However defensible this position may be in point of policy, the statutory basis for it is weak. After all, collateral remains collateral regardless of whether it is possessed by the secured party for the purposes of security or realization on security. Accordingly, the Ontario cases have tended to hold that so long as the secured party manages to assume possession of the collateral before the debtor's bankruptcy or before the debtor's execution creditors seize the

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[2] [1963] 1 OR 431, 4 CBR (NS) 186, 37 DLR (2d) 419 (Ont CA)

[3] S. 15. "A sale or mortgage or bill of sale that under this Act is void or has ceased to be valid as against a creditor or purchaser or mortgagee under the Act is not, by reason of the fact that the grantee has subsequently taken possession of the chattels sold or mortgaged, rendered valid as against a person who became a creditor, purchaser or mortgagee before the grantee took possession."

[4] (1984) 52 CBR (NS) 225 (SCC)

[5] See, for instance, *Sperry Inc v. CIBC* (1985) 4 PPSAC 314

collateral, it gains perfected status as against them.

The third generation PPSA's attempt to deal directly with the problem but adopt opposite resolutions. The new Ontario PPSA expressly adds "repossession" to "possession" as a perfection method under section 24. The amendment is apparently intended to make it clear that a security interest can be perfected by possession even if possession is for the purposes of realization. Whether it accomplishes this objective is, however, controversial. In the first place, only "repossession" is added, not "repossession or seizure". Technically, possession for the purposes of realization would be by way of repossession only if the secured party were a seller or supplier who started out with possession of the collateral. In most other cases, the secured party would never have had possession of the collateral at any point. More significantly, perhaps the new section retains the controversial wording that possession constitutes a perfection method only while the collateral "is actually held as collateral".

The Western Model PPSA fully clarifies the issue albeit in the opposite policy direction. The concluding words to section 24 expressly state that possession does not constitute perfection where possession was as a result of repossession or seizure. In other words, a secured party who fails to register a nonpossessory security interest in collateral will not be able to cure the consequences of its failure to perfect by a hasty realization on a default. In such a case, the security interest will remain unperfected and therefore subordinate to the third party interests listed in section 20 of the Act including the debtor's execution creditors and the trustee in bankruptcy.

On balance, the approach under the Western Model is preferable to that taken in the new Ontario PPSA. It is consistent not only with the pre-PPSA legislation and jurisprudence but also with the general and long-standing policy underpinning the perfection requirement. Secured parties enjoy a "super priority" over their unsecured counterparts only if they succeed in publicizing their interest in advance. A secured party who has failed to perform this one essential step should not be permitted to escape the rule of ratable sharing that applies among unsecured creditors. Moreover, to permit a secured party to escape subordination by a hasty realization would encourage secured parties to take chances with the registry system thereby undermining its integrity and function.

Taking Possession of a "Security with a clearing agency"

"Security with a clearing agency" is defined in section 1 to include both 'deposited securities', i.e., a certificated security in bearer form, endorsed in blank, or registered in the name of a clearing agency that is in the custody of a clearing agency, and 'uncertificated securities', i.e., a security not in the form of a security certificate that is registered by the issuer in the name of a clearing agency. Taking physical possession of either a deposited or an uncertificated security is impossible - in the former case because there simply is no certificate and in the latter case because the security is in the custody of the clearing agency and cannot be delivered up. As the general definition of "security" in section 1 recognizes, ordinary course business practice is to transfer such securities by an entry in the records of the clearing agency. Section 24(3) recognizes this practice for the purposes of perfection by possession pursuant to section 24(1) by deeming the secured party to have taken possession of the security when the appropriate entries have been made in the records of the clearing agency.

SECTION 25

PERFECTION BY REGISTRATION

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25 **Subject to section 19, registration of a financing statement perfects a security interest in collateral.**

COMMENTARY

General

As a method of perfection, taking possession of the collateral is inherently limited to those types of collateral of which it is possible to take physical or at least symbolic possession: see section 24. No such inherent limitation applies where registration is the perfecting step and section 25 therefore permits a security interest in any category of collateral to be perfected by registration of a financing statement. The details of registration and the registry system form the subject of Part 4 of the PPSA.

Negotiable Collateral

Section 25 of the original Ontario PPSA limited the availability of registration as a perfection method to security interests in chattel paper, goods, intangibles and documents of title. Where the collateral was an instrument or security, taking possession of the collateral was the only method of perfection available. One reason for this limitation lay in the negotiable or quasi-negotiable character of these excluded categories of property. It was felt that to permit a security interest in negotiable property to be perfected by registration would detract from its free transferability by requiring ordinary course transferees of the collateral to search the PPSA registry prior to each dealing. But a search is necessary only if the effect of perfecting a security interest in an instrument or security is to give the secured party priority even over ordinary course transferees. Accordingly, registration has been made a universally available method of perfection in all of the third generation PPSA's, including the new Ontario Act. Where the collateral is negotiable property, ordinary course transferees are protected by a special rule of priority: see section 31. The result is that a registered security interest in an instrument or a security will be effective against the debtor's execution creditors or trustee in bankruptcy but not against ordinary course transferees. Because of the vulnerability of these classes of collateral to transferees, a secured party may still prefer to perfect by taking possession rather than registering or to use registration only as a prophylactic measure in the event it later becomes necessary to release the instrument or security to the debtor for some limited period or purpose.

NOTES

SECTION 26

TEMPORARY PERFECTION DESPITE RETURN OF COLLATERAL TO DEBTOR

26(1) **A security interest perfected under section 24 in**

(a) **an instrument or a security that a secured party delivers to the debtor for the purpose of**

- **(i)** **ultimate sale or exchange,**
- **(ii)** **presentation, collection or renewal, or**
- **(iii)** **registration of a transfer, or**

(b) **a negotiable document of title or goods held by a bailee that are not covered by a negotiable document of title, which document of title or goods the secured party makes available to the debtor for the purpose of**

- **(i)** **ultimate sale or exchange,**
- **(ii)** **loading, unloading, storing, shipping or trans-shipping, or**
- **(iii)** **manufacturing, processing, packaging or otherwise dealing with goods in a manner preliminary to their sale or exchange**

remains perfected, notwithstanding section 10, for the first 15 days after the collateral comes under the control of the debtor.

26(2) **After the 15 day period mentioned in subsection (1) expires, a security interest referred to in this section is subject to the provisions of this Act relating to the perfection of a security interest.**

COMMENTARY

Generally

Where a secured party perfects under section 24 by taking possession of the collateral, the security interest will remain perfected only so long as possession is retained by the secured party. The sole exception is section 26 which permits a security interest perfected by possession to remain perfected notwithstanding a return of the collateral to the debtor and "notwithstanding section 10" (i.e., notwithstanding noncompliance with the writing requirement for nonpossessory security interests). Provided the collateral is released to the debtor for one of the purposes specified in section 26, the security interest will remain perfected for the first 15 days after the collateral comes under the debtor's control.

The rationale for section 26 is commercial convenience, indeed commercial necessity. The drafters recognized that there are legitimate commercial reasons why collateral taken into possession by the secured party has to be temporarily released to the debtor in their common benefit. It is commonplace, for instance, in sales transactions for the bank financing the buyer's purchase of goods to pay the seller only upon receipt of the bill of lading representing the subject goods. While the bank may wish to retain the bill of lading -being a document of title to the goods - as collateral until the buyer pays the purchase money loan, it is frequently necessary for the buyer to present the bill of lading in order to collect the goods from the carrier and resell, tranship or otherwise deal with them in her business. If the bank's security interest were originally perfected by possession under section 24, relinquishment of possession would deperfect the security interest. Section 26 aims to prevent that result by providing a temporary period of perfection during which the security interest will remain perfected notwithstanding that the document of title is made available to the debtor. In view of the short term character of this and the other transactions listed in section 26, it was felt that the secured party should not have to be register in order to maintain its perfected status.

Continuity of Perfection and Effect of Lapse

Upon the expiry of the 15 days, section 26(2) makes it clear that the security interest becomes subject to the general perfection requirements of the Act. Accordingly, the secured party must either retake possession or perfect by registration under section 25 if it wishes to maintain its perfected status. If the latter avenue is chosen, and there is no written security agreement describing the collateral in existence, the secured party should also have the debtor sign one before the 15 days expire. This is because a writing in compliance with section 10 is a prerequisite to attachment and therefore perfection in the case of a nonpossessory security interest (see sections 12 and 19). While section 26 dispenses with the need to comply with section 10 during the fifteen day period, it is reactivated upon the expiry of that period.

If the secured party successfully reperfects before the 15 days expire, the security interest will be regarded as continuously perfected from the date it was originally perfected under section 24: see section 23. Should perfection lapse, however, continuity of perfection will be lost and any attempt to reperfect will be effective only as of the date thereof. Unlike, the case of a lapsed registration (see section 35(7)), the PPSA does not maintain the secured party's pre-lapse priority ranking as against other security interests where perfection by possession lapses. This difference in approach makes sense on both historical and policy grounds. Under pre-PPSA law, possession could be used as an alternative to possession only if the secured party exercised vigilance in maintaining a continued and notorious possession so as to ensure effective public notice. Moreover, where possession is by registration, objective evidence is readily forthcoming as to the earlier existence of the security interest even if registration lapses. But where perfection is by possession, a break in continuity may later make it difficult to establish whether and when a security interest ever existed in the collateral since perfection by this method does not require a written security agreement. Finally, a lapse in the secured party's possession of the collateral must necessarily be a conscious and voluntary decision by the secured party in contrast to a lapse in perfected status by registration where simple inadvertence is the more likely explanation.

Priority Effect of Bankruptcy during the Temporary Perfection Period

The wording of section 26 makes it clear that the security interest remains perfected for the first 15 days after the collateral comes into the debtor's control even if perfection lapses upon the expiry of that period. This means that if the debtor becomes bankrupt during the 15 day period, the security interest will still be effective against the trustee in bankruptcy because the security interest was still perfected at the relevant priority point. This is in marked contrast to the conflict of laws provisions of the Act under which a subsequent lapse causes the security interest to be retroactively deperfected as of the commencement date of the temporary perfection period: see sections 5-7.

Priority Effect of Sale or Lease during the Temporary Perfection Period

If the collateral is goods, temporary perfection under section 26 will not necessarily protect the secured party against a sale or lease of the collateral by the debtor. Under section 30(5) of the Act, a security interest in goods is subordinated to the interest of a bona fides purchaser or lessee who takes her interest for value without notice during any of the temporary perfection periods prescribed by the Act, including that afforded by section 26. See further section 30(5). Where the collateral is an instrument, a security, or a negotiable document of title, the secured party will likewise be vulnerable to bona fides transferees by operation of section 31 of the Act: see further section 31.

NOTES

SECTION 27

PERFECTION WHERE GOODS HELD BY A BAILEE

27(1) **Subject to section 19, a security interest in goods in the possession of a bailee is perfected by**

- **(a)** **issue of a document of title by the bailee in the name of the secured party,**
- **(b)** **where the bailee has issued a negotiable document of title to the goods, perfection of a security interest in the negotiable document of title,**
- **(c)** **a holding by the bailee on behalf of the secured party in accordance with section 24,**
- **(d)** **deposit, by a secured party to whom a non-negotiable receipt has been transferred, of the transfer with the warehouseman who issued the receipt in accordance with section 21 of the *Warehouse Receipts Act*, or**
- **(e)** **registration of a financing statement relating to the goods.**

27(2) **The issue of a negotiable document of title covering goods does not preclude any other security interest in the goods arising during the period that the negotiable document of title is outstanding.**

27(3) **A perfected security interest in a negotiable document of title covering goods takes priority over a security interest in goods otherwise perfected after the goods become covered by the negotiable document of title.**

COMMENTARY

Purpose

Section 27 applies when the collateral is goods in the possession of a third party bailee. Section 24 already makes it clear that possession by a third party will suffice to perfect a security interest in goods provided the third party is clearly in possession on behalf of the secured party. This aspect of section 24 is reconfirmed by section 27(1)(c) which provides that a security interest in goods in the possession of a bailee may be perfected by a holding by the bailee on behalf of the secured party in accordance with section 24. The availability of the other general method of perfection - registration under section 25 - is reconfirmed by in section 27(1)(e) which states that a security interest in goods in the possession of a bailee may be perfected by registration of a financing statement relating to the goods.

But section 27 is intended to do more than simply reiterate the availability of the general methods of perfection already provided by sections 24 and 25 to goods in the possession of a bailee. The principal purpose of the section is to address the complexities that arise where the bailee has issued a document of title covering the goods in her possession. Sections 27(1)(a), (b) and (d) provide supplementary methods of perfection in this situation while sections 27(2) and (3) deal with the priority implications that arise when a security interest in goods covered by a negotiable document of title may be perfected either directly or through their documentary clone.

Documents of Title[1]

In its broadest sense, a document of title is a writing issued by a bailee of goods that states to whom the bailee's delivery obligation is owed. A writing acquires the status of a document of title through mercantile custom as sanctioned by either common law or statute. There are two principal kinds of documents of title: the bill of lading issued by a carrier for goods taken into possession for the purposes of transportation; and the warehouse receipt or dock warrant or receipt issued by a warehouser for goods taken into possession for the purposes of storage.

Bill of Lading. The bill of lading acquired its function as a document of title at a very early period in order to give shippers a means of dealing with their goods while afloat in the custody of the carrier. From the beginning the courts were prepared to recognize mercantile custom in this regard and even today the legal incidents of bills of lading are principally determined by common law sanction of trade usage.

In practice, bills of lading come in two forms. An *order bill of lading* makes the goods deliverable to the order of a named person or to a name left blank or to bearer and its surrender properly indorsed is necessary before the carrier will release the goods. By mercantile custom, order bills of lading are sometimes labelled *"negotiable"*. In this context, negotiable simply means transferable by delivery with any necessary indorsement so as to effect a transfer of whatever property in the goods represented by the bill that it was the intention of the parties to transfer. An order bill of lading is not, however, negotiable in the strict sense of a bill of exchange, the negotiation of which may pass to a holder in due course a far superior title to that held by the transferor[2].

A *straight bill of lading* does not contain some such words as "to order" but simply names a specific consignee of the goods. A straight bill of lading is *not negotiable* or transferable by delivery and indorsement and the specified consignee is entitled to take delivery of the goods upon being notified of their arrival by the carrier whether or not she produces the bill of lading.

Warehouse receipts, etc. At common law, the courts were not prepared to lend legal sanction to mercantile custom under which an interest in warehoused assets could be transferred by a transfer of the receipt covering them with any necessary endorsement. Legislative intervention was necessary for the warehouse receipt to be recognized as a document of title, a process that reached complete fruition in the *Uniform Warehouse Receipts Act* proposed by the Uniformity Commissioners in 1943. Modelled on pre-UCC American uniform legislation, the Act was passed in a number of common law provinces including New Brunswick and offers a fairly comprehensive, if somewhat dated, statutory source of the law in the field.

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[1] For a comprehensive discussion and analysis, see generally, Wood, "The Pledge of Documents of Title in Ontario" (1984) 9 Can Bus L J 81. See also Mocatta et al, Scrutton on Charterparties and Bills of Lading, 19th ed., London (1984) at p 184 et seq; Rogers, Falconbridge on Banking and Bills of Exchange, 7th ed. Toronto (1969) at pp 199-203, 215-217.

[2] However, the Sale of Goods Act and the Factors and Agents Act exceptions to the nemo dat principle applicable to buyers and sellers in possession of goods without title also extend to documents of title in the form both of bills of lading and warehouse receipts.

The *Warehouse Receipts Act* distinguishes between negotiable and non-negotiable warehouse receipts. A *negotiable warehouse receipt* is one made out to the order of bearer or a named person that is capable of transfer by delivery with any necessary indorsement. It is treated as truly symbolic of the goods in that its negotiation is effective without more to transfer both the transferor's interest in the goods and the benefit of the warehouser's obligation of custody and delivery. For this reason, the Act makes surrender of the receipt with any necessary indorsement a condition of delivery of the goods by the warehouser to the bearer. The Act also confers quasi-negotiable status on negotiable warehouse receipts in the bills of exchange sense of negotiability in that negotiation is not impaired by breach of duty, fraud, mistake or duress and in that bona fide holders without notice are protected.

A *non-negotiable warehouse receipt*, by contrast, is given little more legal effect than a receipt. It is not capable of transfer by delivery and endorsement and while the goods may be made the subject of a transfer by the holder of the receipt, the transfer is not binding on the warehouser in the absence of deposit or notification nor is surrender of the receipt a condition of delivery of the goods.

PPSA Definition of "document of title"

The concept of "document of title" under the PPSA is clearly intended to cover both negotiable and non-negotiable writings. Document of title is defined in section 1 as "a writing issued by or addressed to a bailee that (i) covers goods in the bailee's possession ... and (ii) in which it is stated that the goods identified in it will be delivered to a named person or to the transferee of the person [i.e., a straight bill of lading or a non-negotiable warehouse receipt], to bearer or to the order of a named person [i.e., an order bill of lading or a negotiable warehouse receipt].

While section 27 distinguishes between negotiable and non-negotiable documents of title, the distinction is not defined in the PPSA. In this respect, section 27 is modelled on its UCC counterpart which, however, was drafted so as to integrate with the comprehensive codification of the law on documents of title contained in UCC Article 7. While a Canadian adaptation of Article 7 has been recommended, the governing law still remains the fragmented mixture of common law, trade usage and discrete statutory enactment outlined summarily above and it is to these sources that one must still turn in order to determine whether and when a document of title should be characterized as negotiable for the purposes of section 27.

Perfecting a Security Interest in Goods Covered by a Document of Title

Sections 27(1)(a) and (b) provide that a security interest in goods in the possession of a bailee is perfected either by a holding by the bailee on behalf of the secured party pursuant to section 24 or by registration of a financing statement covering the goods. These methods of perfection are available regardless of whether or not the goods are covered by a document of title and, as noted above, are little more than a confirmation of the application of sections 24 and 25 in this context.

Sections 27(1) (c) (d)and (e) offer additional methods of perfection in the situation where the goods are held by a bailee who has issued a document of title.

Under section 27(1)(a), a security interest in goods in the possession of a bailee is perfected by issue of a document of title by the bailee in the name of the secured party. This method of perfection is available regardless of whether the document of title is negotiable or nonnegotiable. Accordingly the issue of a straight bill of lading naming the secured party as consignee for the goods will be equally effective as the issue of an order bill of lading made out to the order of the secured party. Similarly, the issue of a nonnegotiable warehouse receipt naming the secured party as the person to whom delivery will be made will be just as effective as the issue of a negotiable warehouse receipt made out to the order of the secured party. The distinction between negotiable and nonnegotiable is irrelevant because in either case the bailee is clearly in possession of the goods on the secured party's behalf. As a method of perfecting an interest in goods, the issue of a document of title in the name of the secured party is in other words nothing more than a variation of the principle in sections 24 and 27(1)(c) that a security interest in goods in the possession of a bailee can be perfected by a holding by the bailee on behalf of the secured party.

The distinction between a negotiable and a nonnegotiable document of title becomes critical, however, if the document of title is issued in blank or in the name of the debtor rather than the secured party. While a nonnegotiable document of title is little more than a receipt, a negotiable document is regarded as the functional equivalent of the goods it represents. Accordingly, under section 27(1)(c) perfection of a security interest in a negotiable document of title *ipso facto* perfects the security interest in the goods. While perfection may be accomplished by either filing or taking possession of the document of title, the latter is clearly the superior and safer of the two methods: see further section 31.

The final method of perfection provided by section 27 is limited to cases where the bailee is a warehouser who has issued a nonnegotiable receipt covering the goods in its possession. While a nonnegotiable receipt is by definition nontransferable, the *Warehouse Receipts Act* provides that the goods covered by a non-negotiable receipt may be transferred by the holder of the receipt through the execution and delivery of a transfer in writing and that the transferee acquires the benefit of the warehouser's obligation to hold possession of the goods upon deposit of the transfer with the warehouser. Deposit of the transfer with the warehouser is treated, in other words, as the equivalent of the transferee taking possession of the warehoused goods. Accordingly, section 27(1)(e) provides that a security interest in goods in the possession of a bailee is perfected by the deposit of a transfer with the bailee in accordance with the *Warehouse Receipts Act*.

Priority between a Perfected Security Interest in Goods and a Perfected Security Interest in a Negotiable Document of Title covering the Same Goods

If a negotiable document of title embodies title to the goods, does it follow that taking a security interest in the document of title is the only method of taking a security interest in the goods during the period that the document is outstanding? The answer is a qualified no. Consistently with the existing law, section 27(2) makes it clear that the mere issue of a negotiable document of title does not ipso fact preclude the creation of a security interest in the goods directly during the period that the document of title is outstanding. However, section 27(3) embodies the policy conclusion that once the document is issued, the controlling method of perfecting a security interest in the goods is through their document of title. Under the section, a perfected security interest in a negotiable document of title takes priority over a security interest in goods otherwise perfected after the goods become covered by the negotiable document of title. The effect of the section is to displace the normal PPSA rule of priority applicable to competing security interests in the same goods which would give priority according to the order in which perfecting step were taken (section 35(1)). Thus a security interest in goods that is registered after the goods come into the possession of a bailee who has issued a negotiable document of title will be subordinated to a secured party who thereafter takes and perfects a security interest in the document of title.

SECTION 28

SECURITY INTEREST IN PROCEEDS

28(1) **Subject to this Act, where collateral is dealt with or otherwise gives rise to proceeds, the security interest**

(a) continues in the collateral unless the secured party expressly or impliedly authorizes the dealing, and

(b) extends to the proceeds,

but where the secured party enforces a security interest against both the collateral and the proceeds, the amount secured by the security interest in the collateral and the proceeds is limited to the market value of the collateral at the date of the dealing.

28(2) **A security interest in proceeds is a continuously perfected security interest if the interest in the original collateral is perfected by registration of a financing statement that**

(a) contains a description of the proceeds that would be sufficient to perfect a security interest in original collateral of the same kind,

(b) covers the original collateral, if the proceeds are of a kind that are within the description of the original collateral, or

(c) covers the original collateral, if the proceeds consist of money, cheques or deposit accounts in a bank, credit union or similar financial institution.

28(3) **Where the security interest in the original collateral is perfected other than in a manner referred to in subsection (2), the security interest in the proceeds is a continuously perfected security interest but becomes unperfected on the expiration of 15 days after the security interest in the original collateral attaches to the proceeds, unless the security interest in the proceeds is otherwise perfected by any of the methods and under the circumstances prescribed in this Act for original collateral of the same kind.**

COMMENTARY

Scope

Section 28 addresses three issues. What happens to the security interest when the collateral is dealt with so as to give rise to proceeds? When does the security interest extend to the proceeds of the dealing? How is a security interest in the proceeds perfected?

Effect of Disposition on Security Interest in Original Collateral

A debtor ought not to be able to terminate a security interest by its own unilateral decision to dispose of the collateral to a third party. Thus, under existing law, the effect of the debtor's disposition depends on whether or not the disposition was authorized. If unauthorized, the security interest in the collateral survives. If authorized, the disposition determines the security interest.

The existing legal policy makes eminent comment sense and has been carried over without debate in the PPSA. Under section 28(1)(a), where collateral is dealt with or otherwise gives rise to proceeds, the security interest continues in the collateral unless the secured party expressly or impliedly authorized the dealing.

Because it essentially codifies the existing law, pre-PPSA case law on whether a dealing is impliedly authorized so as to determine the security interest will continue to be relevant under the PPSA. The most common example of an authorized dealing is where the collateral is inventory. Though it may be supplied on secured financing terms, inventory in the hands of the debtor is obviously intended for resale rather than consumption or use. Thus, even in the absence of any express authority, the inventory financier will normally be taken to have impliedly authorized the debtor to deal with the collateral free of the security interest in the ordinary course of business[1]. Otherwise, the inventory would be valueless in the debtor's hands and the very purpose of the financing arrangement defeated.

Even where the dealing is unauthorized so that the security interest survives under section 28(1)(a), it does not necessarily follow that the secured party will be able to enforce it against a subsequent buyer or lessee of the collateral. Under section 20(1), an unperfected security interest is subordinated to the interest of a transferee for value of the collateral without knowledge. And under sections 30 and 31 certain transferees take free of even a perfected security interest.

Occasionally, a security agreement will authorize a resale or lease of the collateral but purport to qualify or restrict the debtor's powers. While a dealing in breach of such restrictions may not determine the security interest under section 28, retail buyers and lessees in the ordinary course of trade will be protected provided they are ignorant of any such special restrictions: see section 30(2).

Occasionally, as well, the secured party may consent to the debtor's disposition of collateral subject to a continuing security interest and subject to the transferee becoming the new debtor. If this is the case, the secured party must register a financing statement in the name of the new debtor within fifteen days of the transfer in order to maintain the same priority position it enjoyed as against the original debtor: see section 51.

Security Interest in Proceeds of Disposition of Collateral

Under the existing law, a secured party will usually be able to follow the proceeds of an unauthorized disposition of the collateral as a constructive *cestui que trust* under equitable tracing principles.

Where the disposition is authorized, as it commonly will be in an inventory financing arrangement, the security agreement will usually stipulate that any proceeds derived from the debtor's disposition of collateral are to be held in trust for the secured party. And even where the agreement is silent on proceeds, the courts have been prepared to imply a right to follow the proceeds from the very fact of consent to the disposition of the collateral. After all, "even its absence [i.e., of an express proceeds clause in the security agreement] the principle is plainly to be spelled out that if you sell my goods with my consent, it is on terms that you bring me the money in place of the goods"[2].

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[1] *Dedrick v. Ashdown* (1888) 15 SCR 277; *Flintoft v. Royal Bank* [1964] SCR 631, 47 DLR 2d 141. In the specific case of inventory financed under a "wholesale conditional sales contract", existing law has codified this so-called "trader's exception". Section 9 of the *Conditional Sales Act* provides that where "a seller of goods expressly or impliedly consents that they buyer may sell them in the ordinary course of business, and the buyer so sells the goods, the property in the goods passes to the purchaser from the buyer...".

Section 28(1)(b) makes it plain that a secured party has an automatic right to follow the proceeds of any authorized or unauthorized disposition of the collateral, independently of any express proceeds clause in the security agreement and independently of trust notions.

The rights given by sections 28(1)(a) and (b) are cumulative and not mutually exclusive. In the case of an unauthorized disposition, this means that the secured party will be able to claim a security interest both in the original collateral under section (a) and in the proceeds under section (b). The relationship between a security interest in original collateral and in proceeds of that collateral is not well developed in the existing law and in particular it is unclear whether and when the secured party must elect between the two interests. While section 28(1) makes it clear that the secured party may enforce both, the total amount secured by the two interests is limited to the market value of the collateral at the date of the dealing. The idea behind this limitation is that the secured party's recovery would have been limited to the value of the collateral if the secured party had decided to enforce its security interest at the time of the unauthorized disposition and there is no reason why the value of its security should increase as a result of that disposition.

Proceeds

Before a security interest can attach to proceeds under section 28(1), the assets in question must fall within the PPSA conception of "proceeds". Under section 1, "proceeds" are defined as "identifiable or traceable personal property including fixtures and crops derived directly or indirectly from any dealing with collateral or proceeds of collateral...". A right to an insurance or other indemnity payment can also constitute proceeds under the definition, even though not derived from a dealing as such, if payable for lost or damaged collateral or proceeds of collateral. A payment made to redeem or discharge an intangible, chattel paper, an instrument or security is also expressly included within the concept of proceeds in section 1.

Requirement that Debtor have acquired an Interest in the Proceeds

As defined in section 1, it is not enough for the secured party to establish that the putative proceeds were derived directly or indirectly from a dealing in the collateral or the proceeds of the collateral. It must also be shown that the debtor acquired an interest in the alleged proceeds.

Requirement that Proceeds remain Identifiable and Traceable

The second limitation on the ability to follow rests in the requirement that the proceeds remain "identifiable or traceable" as proceeds derived from a dealing with the original collateral or with proceeds of the original collateral. The words "identifiable *or* traceable" are intended to make it clear that a secured party may use common law and equitable tracing principles to follow proceeds in circumstances where they have become indistinguishably mixed with other property so as to be no longer literally "identifiable" as such. Equity in particular has developed a number of useful presumptions that permit tracing of proceeds in the form of money that have become mixed with moneys of the debtor or some third party in a bank account.

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[2] *Flintoft v Royal Bank of Canada* [1964] SCR 631 per Judson J.

Equity has traditionally required the existence of a fiduciary relationship between the claimant and the person holding assets before a tracing order will be available. A question that has engendered considerable controversy is whether a fiduciary relationship is necessary to permit a secured party to trace proceeds under the PPSA. If so, a secured party would have to expressly stipulate for a trust on all proceeds in the security agreement before a right to use tracing principles would arise. The imposition of such a requirement runs contrary to the automatic nature of the right to proceeds established by section 28(1)(b). In any event, recent jurisprudence has tended to water down the requirement for a fiduciary relationship *strictu senso*, supporting tracing simply on the existence of a constructive trust to remedy unjust enrichment. Section 1(4) of the PPSA is intended to put the matter beyond all dispute and expressly provides that no fiduciary relationship is necessary in order to permit a secured party to trace into proceeds under section 28. Thus, equitable tracing principles are incorporated into the PPSA stripped of any requirement for a fiduciary relationship.

Perfecting a Security Interest in Proceeds where the Security interest in the Original Collateral was Perfected by Possession

Under both the new Ontario PPSA and the Western Model PPSA[3], perfection of a security interest in original collateral automatically perfects a security interest in proceeds provided that the security interest in the original collateral was perfected when the proceeds arose[4]. Whether the secured party need take any further steps to maintain perfection in the proceeds then depends on the method by which the security interest in the original collateral was perfected when the security interest in the proceeds arose. If by any method other than registration, i.e., taking possession, the automatic perfection expires fifteen days (ten days under the Ontario Act) after the debtor acquires an interest in the proceeds unless the security interest in the proceeds themselves is independently perfected under the Act[5]. (This provision is evidently meant to dovetail with the provisions permitting a secured party who has perfected by possession to return the collateral to the debtor for a fifteen or ten day period, as the case may be, without suffering a lapse in perfected status.)

Perfecting a Security Interest in Proceeds where the Security Interest in the Original Collateral was Perfected by Registration

But if the security interest in the collateral was perfected by registration at the time the proceeds arose, the new Ontario PPSA and the Western Model part company on the issue of what must be done to maintain perfection in the proceeds.

Under the Ontario approach, the secured party need do nothing. It will enjoy an automatically perfected security interest in the proceeds for so long as the registration covering the original collateral remains effective. The only exception is where the proceeds take the form of a motor vehicle. Notwithstanding automatic perfection, a person who buys or leases the vehicle as consumer goods in good faith takes it free of any security interest therein unless and until the secured party has registered a financing change statement that sets out the vehicle identification number[6].

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[3] Section 25 of the new Ontario PPSA is meant to clarify rather than to alter what was most likely the intent of the corresponding s. 27 of the old Act. For jurisprudence under the old Ontario section 27, see *Massey-Ferguson Industries Ltd v Bank of Montreal* (1985) 5 PPSAC 27 and *Re Kryzanowski* (1979) 30 CBR (NS) 204.

[4] Ont s. 25(3)

[5] Ont s. 25(4)

Under the Western Model, on the other hand, there are only three circumstances in which a secured party who has registered a security interest covering the original collateral is released from the obligation to independently perfect its security interest in the proceeds upon the expiry of fifteen days from the time the proceeds arose.

(1) where the financing statement covering the original collateral contains a description of the proceeds sufficient to perfect a security interest in original collateral of the same kind;

(2) where the proceeds are of a kind that fall within the description of the original collateral contained in the registered financing statement covering the original collateral;

(3) where the proceeds take the form of money, cheques or deposit accounts in deposit taking institutions.

If the case does not fall within any of these three categories then the secured party is obligated to independently perfect its security interest in the proceeds within fifteen days pursuant to section 28(3). If the secured party perfects the interest in the proceeds before the expiry of that period, the security interest remains continuously perfected. Otherwise perfection lapses upon the expiry of the fifteen days.

The Western Model approach is to be preferred simply because it does retain some publicity and notice function for registration. Under the Ontario approach, a credit searcher cannot rely on a registered collateral description.

The protection awarded intervening purchasers is also broader under the Western Model than it is under the Ontario PPSA. As in the other cases of temporary perfection, all transferees of the collateral for value without notice, not just consumers, will take free of the security interest if the transfer is made during the fifteen day period and before the security interest is perfected permanently[7].

Absolute or Temporary Perfection?

The perfected status of a security interest in proceeds dates from the time the security interest in the original collateral was perfected provided continuity of perfection in the proceeds is maintained throughout in the manner indicated above. It has been held that the period of temporary perfection afforded a secured party will protect it if the debtor becomes bankrupt within that period even though the secured party fails to permanently perfect its interest in the proceeds[8].

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[6] The Saskatchewan and the other newer Western PPSA's deals with this concern by requiring that a financing change statement record the serial numbers of after-acquired motor vehicles If such registration is not effected, a security interest will also be held to be subordinate to a competing security interest: *Bank of Nova Scotia v. Royal Bank of Canada* (1987) 8 PPSAC 17.

[7] See section 30(5)

[8] See *Central Refrigeration & Restaurant Services Inc . CIBC* (1986) 5 PPSAC 262.

NOTES

SECTION 29

PERFECTION AND PRIORITY WITH RESPECT TO RETURNED, SEIZED OR REPOSSESSED GOODS

29(1) Where a debtor sells or leases goods that are subject to a security interest under circumstances in which the buyer or lessee takes free of the security interest under section 28(1)(a) or 30, the security interest reattaches to the goods if

(a) the goods are returned to, seized or repossessed by the debtor or by a transferee of chattel paper created by the sale or lease, and

(b) the obligation secured remains unpaid or unperformed,

29(2) Where a security interest reattaches under subsection (1), the perfection of the security interest and the time of registration or perfection is determined as if the goods had not been sold or leased if the security interest was perfected by registration at the time of the sale or lease and the registration is effective at the time of the return, seizure or repossession.

29(3) Where a sale or lease of goods creates an account or chattel paper, and

(a) the account or chattel paper is transferred to a secured party, and

(b) the goods are returned to, seized or repossessed by the debtor or by the transferee of the chattel paper,

the transferee of the account or chattel paper has a security interest in the goods that attaches when the goods are returned, seized or repossessed.

29(4) Notwithstanding section 24(1), a security interest in goods arising under subsection (3) is perfected if the security interest in the account or chattel paper was perfected at the time of the return, seizure or repossession, but becomes unperfected on the expiry of 15 days thereafter unless the transferee registers a financing statement relating to the security interest or takes possession of the goods by seizure, repossession or otherwise, before the expiration of that period.

29(5) A security interest in goods that a transferee of an account has under subsection (3) is subordinate to a perfected security interest arising under subsection (1) and to a security interest of a transferee of chattel paper arising under subsection (3).

29(6) A security interest in goods that a transferee of chattel paper has under subsection (3) has priority over

(a) a security interest in goods reattaching under subsection (1), and

(b) a security interest in goods as after-acquired property that attaches on the return, seizure or repossession of the goods,

if the transferee of the chattel paper would have priority under section 31(6) as to the chattel paper over an interest in the chattel paper claimed by the holder of the security interest in the goods.

29(7) **A security interest in goods given by a buyer or lessee of the goods referred to in subsection (1) that attaches while the goods are in the possession of the buyer, lessee or debtor and that is perfected when the goods are returned, seized or repossessed has priority over a security interest in the goods arising under this section.**

COMMENTARY[1]

Section 29 offers guidance on questions regarding which the existing law and policy is underdeveloped - the perfected status and priority of the competing security interests that can arise when goods subject to a security interest are sold or leased by the debtor in circumstances where the transferee takes free of the security interest but are then returned to the debtor by the transferee either voluntarily (e.g., because of a defect or other cause for dissatisfaction) or as a result of seizure or repossession by the debtor (e.g., because of a default in payment under the sale or lease).

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[1] The detailed commentary for this section is not yet completed.

SECTION 30

PRIORITY OF BUYERS OR LESSEES OF GOODS

30(1) For the purposes of this section,

(a) "buyer of goods" includes a person who obtains vested rights in goods pursuant to a contract to which the person is a party, as a consequence of the goods becoming a fixture or accession to property in which the person has an interest,

(b) "ordinary course of business of the seller" includes the supply of goods in the ordinary course of business as part of a contract for services and materials,

(c) "seller" includes a person who supplies goods that become a fixture or accession under a contract with a buyer or under a contract with a person who is party to a contract with such a buyer.

30(2) A buyer or lessee of goods sold or leased in the ordinary course of business of the seller of lessor takes free of any perfected or unperfected security interest given by the seller or lessor or arising under section 28 or 29, whether or not the buyer or lessee knows of it, unless the buyer or lessee also knows that the sale or lease constitutes a breach of the security agreement under which the security interest was created.

30(3) A buyer of lessee of goods that are acquired as consumer goods takes free of a perfected of unperfected security interest in the goods if the buyer or lessee

(a) gave value for the interest acquired, and

(b) bought or leased the goods without knowledge of the security interest.

30(4) Subsection (3) does not apply to a security interest in

(a) a fixture, or

(b) goods the purchase price of which exceeds $1,000.00 or, in the case of a lease, the market value of which exceeds $2,000.00.

30(5) A buyer or lessee of goods takes free of a security interest that is temporarily perfected under subsection 26(1), 28(3), or 29(4), or a security interest the perfection of which is continued under section 51 during any of the 15-day periods referred to in those subsections, if the buyer or lessee

(a) gave value for the interest acquired, and

(b) bought or leased the goods without knowledge of the security interest.

30(6) Where goods are sold or leased other than in the ordinary course of business of the seller or lessor, the buyer or lessee takes free from any security interest in the goods perfected under section 25 if

(a) the buyer or lessee bought or leased the goods without knowledge of the security interest, and

(b) the goods were not described by serial number in the registration relating to the security interest.

30(7) Subsection (6) applies only to goods that at the date of the sale or lease were held by the seller or lessor as equipment and that are of a kind that may be described in a registration by serial number.

30(8) A sale or lease under subsections (2), (3), (5) or (6) may be

(a) for cash,

(b) by exchange for other property, or

(c) on credit,

and includes delivering goods or a document of title under a pre-existing contract for sale but does not include a transfer as security for, or in total or partial satisfaction of, a money debt or past liability.

COMMENTARY[1]

Purpose

Existing law protects purchasers for value without notice of an unregistered non-possessory security interest. The same policy is maintained in section 20 of the PPSA under which an unperfected security interest is subordinated to the interest of a transferee for value who takes without knowledge of the security interest before it is perfected. The rationale for protecting transferees against unregistered and otherwise unperfected security interests is obvious: the absence of any means of public notice.

Occasionally, however, commercial convenience or elementary fairness may demand protection for the purchaser for value without notice regardless of whether the security interest is perfected or unperfected. It is these exceptional cases that form the subject of section 30.

Buyers and Lessees in the Ordinary Course of Business

Under existing New Brunswick law, retail purchasers in the ordinary course of business generally take free of any security interest to which the trader's inventory may be subject. Otherwise, the inventory would be valueless in the debtor's hands and the very purpose of the financing arrangement defeated. After all, collateral that constitutes inventory in the hands of the debtor is obviously intended for resale rather than consumption or use. Moreover, business would grind to a standstill if retail buyers had to verify the trader's title before making a purchase. Thus, even in the absence of any express authority, an inventory financier will be taken to have impliedly authorized the debtor to deal with the collateral free of the security interest in the ordinary course of business[2].

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[1] The detailed commentary for this section is not fully completed.

In the case of inventory financed under a "wholesale conditional sales contract", this so-called "trader's exception" has been codified in the *Conditional Sales Act*. Section 9 provides that where "a seller of goods expressly or impliedly consents that the buyer may sell them in the ordinary course of business, and the buyer so sells the goods, the property in the goods passes to the purchaser from the buyer...".

Section 30(2) of the PPSA is likewise intended to codify the trader's exception endemic in the existing law. The section protects both buyers and lessees of goods so long as the goods were sold or leased in the ordinary course of business of the seller or lessor.

If the security interest was given by the seller or lessor, the ordinary course buyer may not have to rely on the protection given by section 30(2) in any event. If the dealing was expressly or impliedly authorized by the secured party, the security interest will be determined in any event by section 28. Occasionally, however, the inventory financing agreement may restrict the debtor's ordinary course trading powers. While a dealing in breach of such restrictions may then not terminate the security interest under section 28, ordinary course buyers and lessees will still be protected under section 30(1). Indeed, they will be protected even if they know the goods are subject to a security interest provided they take without knowledge that the disposition is in violation of some term of the security agreement under which the security interest was created. In other words, the protection granted by section 30(1) depends on the seller's or lessor's apparent and not actual trading authority.

Section 30(1) protects ordinary course buyers and leases not just from security interests given by the seller or lessor but also from security interests "arising under sections 28 or 29".

Consumer Goods of a Value Less than $2,000

Under sections 30(5) and (6), a buyer or lessee for value without notice of goods acquired as consumer goods takes free of either a perfected or unperfected security interest where the goods have a value less than $2,000. The section is a "garage or newspaper sale" provision intended to relieve consumer purchasers from the burden of searching the Registry where the transaction is a private and the goods have a relatively low value.

Temporary Perfection

Various sections of the Act provide that a security interest will be temporarily perfected for a 15 day period notwithstanding the absence of either possession or registration. Section 30(5) is designed to ensure that transferees of the collateral during any of these periods are protected if they took their interest at a time when there was no public disclosure of the temporarily perfected interest.

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[2] *Dedrick v. Ashdown* (1888) 15 SCR 277; *Flintoft v. Royal Bank* [1964] SCR 631, 47 DLR 2d 141; *McPherson v. Moody* 35 NBR 51.

Serial Numbered Goods

Under the PPSA Regulations, various types of goods will be designated as serial numbered goods in order to enable a search to be conducted by this alternative search criterion. This is an especially valuable possibility where the debtor has transferred its interest in the collateral so that a purchaser dealing with the debtor's transferee will not be able to find out about the existence of the security interest by conducting a search according to debtor name. Under the Regulations, serial number registration is mandatory in some instances and permissive in others. Where registration is mandatory, the failure to register will be fatal to the registration: see section 43. But where registration is permissive, noncompliance has less drastic consequences. The security interest will remain effective against the debtor's trustee in bankruptcy and execution creditors but subordinated to subsequent lessees and buyer pursuant to sections 30(6) and (7).

SECTION 31

PRIORITY OF HOLDERS OR PURCHASERS OF MONEY, INSTRUMENTS, SECURITIES, DOCUMENTS OF TITLE OR CHATTEL PAPER

31(1) A holder of money has priority over a security interest in it perfected under section 25 or temporarily perfected under subsection 28(4) if the holder

(a) acquires the money without knowledge that it is subject to a security interest, or

(b) is a holder for value, whether or not that person acquires the money without knowledge that it is subject to a security interest.

31(2) A creditor who receives an instrument drawn or made by a debtor and delivered in payment of a debt owing to the creditor by that debtor has priority over a security interest in the instrument whether or not the creditor has knowledge of the security interest at the time of delivery.

31(3) A purchaser of an instrument or a security has priority over any security interest in the instrument or security perfected under section 25 or temporarily perfected under subsection 28(3) if the purchaser

(a) gave value for the instrument or security,

(b) acquired the instrument or security without knowledge that it is subject to a security interest, and

(c) subject to paragraph (d) took possession of the instrument or security,

(d) where the security is of a kind that is transferred by an entry on the records of a clearing agency, an entry has been made in the records of the appropriate agency indicating that the security has been transferred to the purchaser.

31(4) A holder to whom a negotiable document of title is negotiated has priority over a security interest in the document of title that is perfected under section 26 or subsection 28(4) if the holder

(a) gave value for the document of title, and

(b) acquired the document of title without knowledge that it is subject to a security interest.

31(5) For the purposes of subsections (3) and (4), a purchaser of an instrument or a security or a holder of a negotiable document of title who acquired it under a transaction entered into in the ordinary course of the transferor's business has knowledge only if the purchaser acquired the interest with knowledge that the transaction violates the terms of the security agreement creating or providing for the security interest.

31(6) A purchaser of chattel paper who takes possession of it in the purchaser's ordinary course of business and for new value has priority over any security interest in the chattel paper that

(a) was perfected under section 25, if the purchaser does not have knowledge at the time of taking possession that the chattel paper is subject to a security interest, or

(b) has attached to proceeds of inventory under section 28, whatever the extent of the purchaser's knowledge.

COMMENTARY[1]

The existing registration statutes confine registration requirements to security agreements covering chattels and book debts. In extending its coverage to all forms of personal property, the PPSA will bring within its scope negotiable collateral such as securities, instruments, money, etc. and confirm the right of secured parties to take security interests in these forms of collateral. But this right must not be allowed to impede the *raison d'etre* for negotiability, *i.e.*, to enable purchasers of those forms of property that are freely traded in the public marketplace to take possession and give value without any worries about the potential competing claims of previous owners and third parties. Section 31 is designed to preserve negotiability notwithstanding that there is a registered security interest in the negotiable property.

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[1] A detailed commentary for this section has not yet been completed.

SECTION 32

PRIORITY OF REPAIRER'S LIEN

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32 **A lien on goods that arises as a result of the provision, in the ordinary course of business, of materials or services in respect of the goods, has priority over a perfected or unperfected security interest unless the lien arises under an enactment that gives priority to the security interest.**

COMMENTARY

Purpose

Section 32 is an exception to section 4(a) which generally excludes "a lien, charge or other interest given by rule of law or statute" from the scope of application of the PPSA. Section 32 is such an exception. It is intended to provide a general rule for resolving priority conflicts between a security interest in goods arising under the PPSA and a possessory lien for services rendered or materials supplied to the debtor in respect of those goods that arises under the general law. So long as the services or materials were furnished in the ordinary course of business of the lien holder, section 32 confers a superpriority on the lien regardless of whether the PPSA security interest is perfected or unperfected and regardless of its date of perfection.

Common Law Background

The superpriority granted to the lien holder by section 32 reflects long-standing legal policy. True, at common law the holder of a possessory lien theoretically did not enjoy priority over a prior security interest unless the lien was created with the knowledge or approval (express or implied) of the secured party[1]. However, the courts readily implied an actual or apparent authority to confer a lien in all cases where the possession of a chattel was given to another on terms that the person in possession keep it in good order and repair. On the theory, repairers and other service-providers routinely prevailed over a conditional seller or hirer or mortgagee of the chattels even in the face of a publicly registered security agreement containing an express promise by the debtor not to create any liens or encumbrances on the chattels. The justice of the case was seen to be in favour of the lien holder insofar as the secured party would have had to repair or maintain the collateral itself had it repossessed or seized before the work was done. This being the case, why should the secured party get the benefit of the value added to the collateral without paying for it. There was also some judicial concern that without the security of their lien, repairers would not perform the work[2].

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[1] *Bowmaker, Limited v. Wycombe Motors, Limited* [1946] KB 505.

[2] For an illustrative discussion of all of the foregoing points, see *Commercial Finance*

Statutory Exceptions to Superpriority?

Section 32 grants priority to the lien holder "unless the lien arises under an enactment that gives priority to the security interest". In New Brunswick, as in many other common law jurisdictions, the law governing common law possessory liens of the type contemplated by section 32 has been codified and supplemented by statute: *The Lien on Goods and Chattels Act* and *The Warehouseman's Lien Act*. The main point of these statutes was to extend a right to the lien holder to sell the liened chattels and apply the proceeds towards the debt, the remedy at common law being limited to a mere passive right of retention. But there is nothing in either *Act* that detracts from the rule of priority established by section 32. On the contrary, the *Warehouseman's Lien Act* expressly contemplates that a warehouseman's lien will take priority over the holder of a chattel mortgage or conditional sales interest in the liened chattels[3].

A Non-Possessory Repairer's Lien?

In conjunction with the passage of its new PPSA, Ontario replaced its prior statutes on repairer's and warehouseman's liens with a new *Repairer's and Storer's Liens Act*. Much of the new *Act* is essentially a further refinement of the prior common law and statutory law on these types of liens. But Part II of the new *Act* introduces a fundamental change in the law governing repairers' and storers' liens. Both at common law and under the prior statutory law, the preservation of the lien depended on the lien holder maintaining possession of the chattels. Relinquishment of possession extinguished the lien. The new Ontario Act permits repairers and storers to convert their liens from "possessory" to "non-possessory" by registration of a claim for lien under the PPSA registry system. Provided registration is accomplished in time, the lien holder will continue to enjoy a superpriority over a PPSA security interest notwithstanding relinquishment of possession. In most respects, the new Ontario *Act* replicates legislative amendments enacted in western Canada which pre-dated the PPSA.

The validity of this approach depends on what one accepts as the justification for the superpriority conferred by section 32 on lien holders as against consensual security interests. The provision derives from UCC 9-310 and is rationalized on the theory that since the lien holder's services have enhanced or at least preserved the chattel for the benefit of all those with an interest in it, including prior secured parties, it would be inequitable to permit the latter to enjoy the fruits of the lien holder's industry without recompense[4]. But this cannot be a universal explanation since the lien claimant's provision of services or materials may not have affected the value of the chattel at all (as where the lien arises for warehousing services, for instance) and even where it does, the lien holder's invoice may often exceed the amount by which the value of the subject chattel has been increased or preserved.

A supplementary justification for superpriority therefore must be simply to preserve the effectiveness of the lien holder's self-help possessory remedy. But once possession is relinquished, that justification is eliminated. The lien holder is returned to the category of yet another unsecured creditor dealing with a recalcitrant debtor. Accordingly, it is recommended that considerable thought be given before New Brunswick adopts any system for preserving the superpriority of repairers' liens by registration. In the meantime, lien holders

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(continued)
Corporation v. Stratford (1920) 47 OLR 392 (High Ct)

[3] See further the commentary on section 4(a).

[4] See, for instance, *Smith v Atlantic Boat Builder Co*, Fla App 1978, 356 So 2d 359.

who wish to retain their superpriority but relinquish the possession on which it is based will have to first bargain for a security agreement, register a security interest in the chattel and secure a subordination agreement from any prior registered secured party. Immediate attention would be better devoted to modernizing the system for the enforcement of possessory liens, which is reputedly the real source of dissatisfaction in this province with the present law.

NOTES

SECTION 33

FREE ALIENABILITY OF DEBTOR'S RIGHTS IN COLLATERAL

33(1) **For the purposes of this section, a "transfer" includes a sale, the creation of a security interest or a transfer under judgment enforcement proceedings.**

33(2) **Notwithstanding a provision in a security agreement prohibiting transfer or declaring a transfer to be a default, the rights of a debtor in collateral may be transferred consensually or by operation of law but a transfer by the debtor does not prejudice the right of the secured party under the agreement or otherwise, including the right to treat a prohibited transfer as an act of default.**

COMMENTARY

The interest of a secured party in collateral at any given time is limited to the value of the outstanding obligation under the security agreement. The balance - loosely referred to as the debtor's "equity" - may still be made the subject of a further voluntary transfer by the debtor - either absolutely or by way of security - or the subject of execution at the instance of the debtor's judgment creditors[1].

However, security agreements frequently prohibit the debtor from conveying its interest in the collateral without the secured party's permission and further provide that an attempt by the debtor's judgment creditors to execute against the collateral will constitute an act of default under the agreement. Section 33 confirms the legitimacy of such terms as between the debtor and the secured party.

As against third parties, however, it would be wrong to allow such contractual provisions to tie up the debtor's beneficial interest in the collateral to the potential prejudice of the debtor's creditors. A $1 loan could effectively render the debtor's assets judgment proof as well as prevent the debtor from acquiring further sources of financing. Accordingly, section 33 provides that the rights of the debtor in the collateral may be transferred either consensually or by operation of law notwithstanding the inclusion of a provision in the security agreement prohibiting transfer or declaring a transfer to be a default. The provision reflects long-standing legal policy promoting the free alienability of property and discouraging fetters on its disposition.

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[1] *McKay v. Harris* 32 NSR 150. *Memorial and Execution Act* CSNB 1903, c.128, section 25(1): 'Under an execution against goods the Sheriff may seize and sell the goods and chattels of the party against whom the writ is issued and may seize and sell the equity of redemption in any goods or chattels (including leasehold interests in any lands) of the party against whom the writ is issued, and such sale shall convey whatever interest such person had in the goods and chattels at the time of seizure".

NOTES

SECTION 34

PRIORITY OF PURCHASE MONEY SECURITY INTEREST

34(1) Subject to section 28, a purchase money security interest in

(a) collateral or its proceeds, other than intangibles or inventory, that is perfected not later than 15 days after the day the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier, or

(b) an intangible or its proceeds that is perfected not later than 15 days after the day the security interest in the intangible attaches,

has priority over any other security interest in the same collateral given by the same debtor.

34(2) Subject to subsection (5) and section 28, a purchase money security interest in inventory or its proceeds has priority over any other security interest in the same collateral given by the same debtor if

(a) the purchase money security interest in the inventory is perfected at the time the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier,

(b) the secured party gives a notice to any other secured party who has, before the time of registration of the purchase money security interest, registered a financing statement containing a description that includes the same item or kind of collateral,

(c) the notice referred to in paragraph (b) states that the person giving the notice expects to acquire a purchase money security interest in inventory of the debtor, and describes the inventory by item or kind, and

(d) the notice is given before the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier.

34(3) A notice referred to in subsection (2) may be given in accordance with section 69 or by registered mail addressed to the address of the person to be notified as it appears in the financing statement referred to in subsection (2)(b).

34(4) Subject to section 28, a purchase money security interest in goods and its proceeds, taken by a seller, lessor or consignor of the collateral, that is perfected

(a) in the case of inventory, at the date a debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier, and

(b) in the case of collateral other than inventory, no later than 15 days after a debtor, or another person at the request of a debtor, obtains possession of the collateral, whichever is earlier,

has priority over any other purchase money security interest in the same collateral given by the same debtor.

34(5) A non-proceeds security interest in accounts given for new value has priority over a purchase money security interest in the accounts as proceeds of inventory if a financing statement relating to the security interest in the accounts is registered

(a) before the purchase money security interest is perfected or

(b) a financing statement relating to it is registered.

34(6) A non-proceeds purchase money security interest has priority over a purchase money security interest in the same collateral or proceeds, if the non-proceeds purchase money security interest is perfected

(a) in the case of inventory, at the date a debtor, or another person at the request of a debtor, obtains possession of the collateral, whichever is earlier, and

(b) in the case of collateral other than inventory, not later than 15 days after a debtor, or another person at the request of a debtor, obtains possession of the collateral, whichever is earlier.

34(7) For the purposes of this section, where goods are shipped by common carrier to a debtor or to a person designated by a debtor, the debtor is deemed not to have obtained possession of the goods until the debtor has obtained actual possession of the goods or a document of title to the goods, whichever is earlier.

34(8) A perfected security interest in crops or their proceeds given for value to enable a debtor to produce the crops and given

(a) while the crops are growing crops or

(b) during a period of six months immediately prior to the time the crops become growing crops,

has priority over any other security interest in the crops given by the same debtor.

34(9) A perfected security interest in fowl, cattle, horses, sheep, swine or fish or their proceeds given for value to enable the debtor to acquire food, drugs or hormones to be fed to or placed in the animals or fish has priority over any other security interest in the animals or fish or their proceeds given by the same debtor other than a perfected purchase money security interest.

COMMENTARY[1]

Purpose

Section 34 awards a superpriority to a purchase money security interest (as defined in section 1) in the same collateral as against any other security interest in the same collateral provided it was given by the same debtor. Section 34 complements section 20 of the Act which accords a similar superpriority as against the debtor's execution creditors, trustee in bankruptcy and non ordinary course transferees by permitting a grace period for perfection. Note as well the superpriority accorded to PMSI's where they take the form of accessions and fixtures by sections 36 and 37.

Rationale for PMSI Superpriority

The principal rationales for PMSI superpriority are twofold. Firstly, prior secured parties are not prejudiced by their subordination to a subsequent PMSI-holder since their funds were not used to finance the collateral. On the contrary, why should they take ahead of the party without whose injection of credit or capital the collateral would not have formed part of the debtor's assets in the first instance? Secondly, PMSI superpriority ensures the availability of alternate sources of financing for the debtor thereby diluting the monopoly otherwise enjoyed by the secured party who manages to make the first perfecting step.

The superpriority accorded to PMSI's by the PPSA largely reflects existing commercial policy. Where the PMSI takes the form of a conditional sales contract, the conditional vendor will normally take priority on the basis of its reservation of legal title. Where it takes the form of a chattel mortgage on specific collateral, the issue of superpriority is a little more complicated. True, Canadian jurisprudence, unlike the English, has never developed the concept of the purchase money chattel mortgage as such. Nonetheless, the courts have generally managed to award a *de facto* superpriority to purchase money chattel mortgages on the basis of one or the other of two other priority doctrines. The first is that a legal chattel mortgage taken without notice in a present specific asset has priority over a prior equitable mortgage or charge on present and future assets. The second is that a fixed and specific mortgage in present assets takes priority over a prior uncrystallized floating charge on the theory that so long as the charge remains floating the debtor has the power to create prior-ranking specific encumbrances against its assets as part of its power of carrying on business in the normal course pending crystallization.

Requirements for Superpriority of PMSI's in All Collateral Except Inventory

Section 34(1)(a) applies to a purchase money security interest taken in all forms of tangible collateral other than inventory. To gain superpriority, the PMSI holder must perfect not later than 15 days after the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier[2].

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[1] The detailed commentary for this section is not fully completed.

[2] The new Ontario PPSA adds the words "as a debtor" in order to ensure that the PMSI holder who relinquishes possession to a prospective debtor for a "trial" period does not run out of time to perfect. The Western PPSA model does not carry this over, presumably because the definition of "debtor" in section 1 of the Act makes it clear that that status is not

Where the collateral takes the form of an intangible, it is impossible to take physical possession of it. Accordingly, section 34(1)(b) substitutes the concept of attachment as the relevant event from which the grace period for perfection commences to run.

Rationale for Grace Period

While the PPSA generally eschews the use of grace periods, it recognizes the need for an exception in the case of a PMSI in non-inventory collateral. In the first place, purchase money financing is frequently on-the-spot financing with no or little lead-up negotiations. Without a grace period to effect registration, the supply of purchase money credit might well be diminished. Secondly, the provision of a grace period reflects the existing law and therefore existing commercial expectations at least where the PMSI takes the form of a conditional sale. Unlike the other three registration statutes currently in effect in New Brunswick, the *Conditional Sales Act* does not provide that the conditional seller's reservation of title takes effect against subsequent mortgagees only on registration. On the contrary, the conditional sale will be effective against subsequent mortgagees immediately the agreement is executed provided that the agreement is signed by the debtor within ten days of delivery of the goods and registered within 30 days of execution.

Requirements for Superpriority of PMSI'S in Inventory

Under section 34(2), the same rule of superpriority applies to PMSI's in inventory. But in this case, there is no grace period afforded for registration. Rather, the PMSI holder must ensure that its security interest is perfected at the time either the debtor, or another person at the request of the debtor, obtains possession of the collateral, whichever is earlier (section 34(2)(a)). Moreover, there is an additional requirement that the PMSI holder give written notice to any secured party who has registered a financing statement covering collateral of the same type or kind before the PMSI is registered (section 34(2)(b)). The required contents of the notice are set out in section 34(2)(c). Section 34(2)(d) provides that the notice must be given before possession of the collateral is transferred to the debtor. Notice may be effected either in accordance with section 69 or in the manner stipulated in section 34(3).

The reason for the absence of a grace period and an additional requirement of notification in the case of a PMSI in inventory is that a prior registered secured party may also be financing the debtor's ongoing acquisition of inventory by making periodic advances against incoming allotments of inventory. In the absence of a notice requirement, the prior secured party might be misled into making an advance against inventory that in fact constitutes collateral under a purchase money financing arrangement subsequently entered into with another secured party.

Priority between Two or More PMSI's in the Same Collateral

Under section 1, "purchase money security interest" is defined to include not only the classic conditional sales agreement but also the classic chattel mortgage where the object of the mortgage loan is to finance the debtor's acquisition of the collateral from somebody else. This extension of the concept of purchase money security interest beyond conditional sales *simpliciter* makes it possible to have two perfected purchase money security interests in the

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(continued)
acquired unless and until there is an obligation secured.

same collateral. Suppose, for instance, that the debtor buys a $20,000 automobile with a down payment of $5,000 borrowed from one secured party and finances the balance of $15,000 under a conditional sales contract with the automobile dealer.

Under the existing law, the conditional seller, by virtue of its retention of "legal title" in the automobile, would enjoy priority over the other secured party (provided the conditional sales agreement is registered). Section 34(3) of the Act is intended to preserve the supplier's common law priority regardless of the order of registration of the two PMSI's[3]. This approach means that the cash supplied by the PMSI lender is paid to the very PMSI seller or supplier who gains priority over it. However, it is justified not only because a first-in-time rule of priority would disrupt existing commercial expectations but because the ability to retain a security interest in its products is generally more central to the successful operation of the supplier's than the general financier's business.

Priority between Inventory and Accounts Financiers

Section 34(6) addresses a priority problem for which the existing law does not offer any fully-developed solution: a priority contest between an inventory financier claiming a security interest in the debtor's accounts as proceeds of the sale of inventory and a prior-registered accounts financier claiming an interest in the accounts as original collateral under a security agreement covering the debtor's present and future accounts. In one pre-PPSA Ontario case, the accounts financier was awarded priority notwithstanding a stipulation in the inventory financing agreement that any proceeds derived from the sale of the inventory were to be held in trust for the inventory financier[4]. Such a trust agreement, it was reasoned, conferred a mere *in personam* right and therefore could not affect the prior real rights of the third party accounts financier. In a more recent Nova Scotia case, on the other hand, priority was awarded to the inventory financier on the theory, *inter alia*, that since the accounts arose already impressed with an obligation to turn them over to the inventory financier, the debtor had no interest left to which account financier's security interest could attach[5]. However, the precise reasoning in support of this ruling is problematic nor is it clear how much the court was influenced by certain special circumstances present in the case.

Under both section 28 and section 34(2), A PMSI in inventory automatically extends to any proceeds derived from the sale of the inventory. Thus, the inventory financier will take priority on the basis of its PMSI superpriority unless an exception is created in favour of the accounts financier. Whether such an exception is warranted has been the subject of considerable debate in PPSA jurisdictions in Canada and in UCC jurisdictions in the United States and an issue on which the Ontario PPSA and the Western Model reach opposing conclusions. In favour of the inventory financier, it can be said that the same policy that supports PMSI superpriority in the original collateral also favours PMSI superpriority in the accounts derived from its sale: since *ex hypothesi* the monies of the prior accounts financier were not used to acquire the inventory, priority should go to the inventory financier without whom the proceeds would not have been generated in the first instance.

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[3] The old Ontario Act did not contain any express priority rule to deal with a priority dispute between two purchase money security interests in the same collateral. *National Trailer Convoy of Canada v. Bank of Montreal* (1980) 1 PPSAC 87 (Ont SC) suggested that the s. 34(3) super-priority rule for pmsi's applied only in the case of a priority dispute between a pmsi and a non-pmsi and that the s. 35(1)(a) residual first-in-time priority rule applied to resolve priorities between the two pmsi's. Section 33(3) of the new Ontario PPSA now provides that the supplier's pmsi has priority over any other pmsi, regardless of the order of registration.

[4] *Re Fred's Farm Implements* (1957) 36 CBR 125 (Ont SC)

[5] *Royal Bank v. GMAC* (1985) 18 DLR (4th) 201 (NSCA), per Hart JA especially at 221.

But while the account financier's monies may not have gone towards acquisition of the collateral, they may well have gone towards its custody and sale as part of its general financing of the debtor's ongoing business expenses. More importantly, subordination of the accounts financier would make accounts financing a very risky business. To the extent subsequent accounts represented the sale of inventory, the value of the collateral would be nil and the accounts financier may not be in a position or have sufficient information to judge the extent of the risk in advance. The inventory financier is in a better position to protect itself since it will be able to obtain notice of the prior accounts interest by a search of the registry and can then either secure a subordination agreement from the accounts financier or refuse the financing. Accordingly, section 34(5) creates a special priority for the new accounts financier.

SECTION 35

RESIDUAL (GENERAL) PRIORITY RULES

35(1) Where this Act provides no other method for determining priority between security interests,

(a) priority between conflicting perfected security interests in the same collateral is determined by the order of the occurrence of the following

(i) the registration of a financing statement without regard to the date of attachment of the security interest,

(ii) possession of the collateral pursuant to section 24 without regard to the date of attachment of the security interest, or

(iii) perfection under sections 5, 7, 26, 28, 29, or 73, whichever is the earliest,

whichever is the earliest,

(b) a perfected security interest has priority over an unperfected security interest, and

(c) priority between conflicting unperfected security interests is determined by the order of attachment of the security interests.

35(2) For the purposes of subsection (1), a continuously perfected security interest is to be treated at all times as perfected by the method by which it was originally perfected.

35(3) Subject to section 28, for the purposes of subsection (1), the time of registration, possession or perfection of a security interest in original collateral is also the time of registration, possession or perfection of its proceeds.

35(4) A security interest in goods that are equipment and that are of a kind defined in the regulations as serial numbered goods is not registered or perfected by registration for the purposes of subsection (1), (7) or (8) unless a financing statement relating to the security interest and containing a description of the goods by serial number is registered.

35(5) Subject to subsection (6), the priority which a security interest has under subsection (1) applies to all advances, including future advances.

35(6) A perfected security interest has priority over the interests of persons referred to in section 20(a) only to the extent of

(a) advances made before the interests of the persons arise, or made before the sheriff seizes the collateral or obtains a right to it under the *Creditors' Relief Act*,

(b) advances made before the secured party acquires knowledge of

(i) the interests of the persons,

(ii) seizure of the collateral by the sheriff, or

(iii) an order giving the sheriff a right to the collateral,

(c) advances made in accordance with

(i) a statutory requirement, or

(ii) a legally binding obligation owing to a person other than the debtor entered into by the secured party before acquiring the knowledge referred to in paragraph (b), and

(d) reasonable costs and expenses incurred by the secured party for the protection, preservation, maintenance or repair of the collateral.

35(7) Where registration of a security interest lapses as a result of a failure to renew the registration or where a registration is discharged without authorization or in error, and the secured party registers the security interest 30 days after the lapse or discharge, the lapse or discharge does not affect the priority status of the security interest in relation to a competing perfected security interest that immediately before the lapse or discharge had a subordinate priority position, except to the extent that the competing security interest secures advances made or contracted for after the lapse or discharge and before the reregistration.

35(8) Where a debtor transfers an interest in collateral which at the time of the transfer is subject to a perfected security interest, that security interest has priority over any other security interest granted by the transferee before the transfer except to the extent that the security interest granted by the transferee secures advances made or contracted for

(a) after the expiry of 15 days from the day the secured party who holds the security interest in the transferred collateral has knowledge of the information required to register a financing change statement showing the transferee as the new debtor, and

(b) before the secured party referred to in paragraph (a) amends the registration to disclose the name of the transferee as the new debtor or takes possession of the collateral.

35(9) Subsection (8) does not apply where the transferee acquires the debtor's interest free from the security interest granted by the debtor.

COMMENTARY

Scope and Purpose

Section 35(1) sets out the general rules of priority as between competing security interests in the same collateral. The stated rules are residual in the sense that they apply only where the Act provides no other method for determining priority. They are subject, in other words, to the more specific rules of priority provided elsewhere in the Act such as the section 34 superpriority rule for PMSI's.

Priority among Competing Perfected Security Interests

Section 35(1)(a) deals with a priority contest that involves competing security interests in the same collateral, all of which are perfected. Under section 19 of the Act, a security interest is perfected when it has attached and all steps required for perfection have been completed. Under section 35(1)(a), priority then falls to be determined according to the order of occurrence of the second of these requirements, viz., the perfecting step, be it registration, taking possession, or temporary perfection. Their respective order of attachment is irrelevant for priority purposes so long as attachment has in fact occurred by the time the priority contest arises. Otherwise, the security interest would still be unperfected and would not fall within the ambit of section 35(1)(a) in the first instance.

The operation of section 31(1)(a) is best illustrated by examining several possible priority contests involving security interests perfected by different steps.

Firstly, all competing security interests were initially perfected by registration. Here, priority will be resolved by the order of registration. As to precisely when registration takes effect, see Part 4.

Where one of the competing security interests was perfected by possession, the other by registration, priority will depend on whether possession was taken before or after registration. If before, the secured party in possession has priority. If after, then the secured party who registered takes priority.

Matters become a little more complicated when one of the competing security interests was perfected by possession or registration while the other is relying on temporary perfection under sections 5, 7, 26, 28, 29 or 73. According to section 35(1)(a), priority is to be resolved in order of the occurrence of registration, possession or temporary perfection, whichever is earliest. However, owing to the combined operation of section 23 and section 35(2) of the Act, a secured party who is relying on temporary perfection may be able, in some circumstances, to take priority over the other secured party even though the period of temporary perfection upon which it is relying commenced after the date at which the other secured party registered or took possession, as the case may be. See further commentary accompanying section 35(2) below.

A first-to-register rule is not a dramatic departure from the result achieved under the existing law albeit that section 35(1)(a) provides a far more straightforward means of arriving at that result. This is because, under the existing registration statutes, a security interest is generally not effective against third parties unless and until it was registered. Once registered, it is true that its chronological priority ranking may still be qualified by a host of legal and equitable rules of priority. But there are exceptions to the first-to-register priority rule under the PPSA, as well, albeit that they are set out within the four corners of the Act rather than being scattered throughout the jurisprudence and general statutory law. It is this codification of the priority rules that likely stands as the single greatest reform achieved by the PPSA.

Priority where Unperfected Security Interests

Under section 35(1)(b), a perfected security interest takes priority over an unperfected security interest. This is a change from the existing registration statutes under which an unregistered security interest was subordinated only as against subsequent mortgagees of the collateral[1].

Under section 35(1)(c), a competition between unperfected security interests is determined by their order of attachment, i.e., creation. This more or less reflects the common law rule of *nemo dat quod non habet* except that the elimination in the PPSA of any distinction between legal and equitable and fixed and floating security interests also removes significant exceptions to that rule.

Priority Ranking where Change In Method of Perfection

Section 20 of the Act provides that a security interest that is originally perfected by one method and is then perfected by another method is to be treated as continuously perfected for the purposes of the Act. Section 35(2) complements section 20 insofar as it provides that in applying the priority rules in sub-section (1), a continuously perfected security interest is to be treated as though it was perfected by the method by which it was originally perfected. Suppose for instance that a secured party who initially perfected by taking possession of the collateral then decides to register a financing statement and to relinquish possession to the debtor. Suppose further that there is already on the record a financing statement covering that collateral. The effect of deemed continuous perfection will be to give the second registered security interest priority over the first.

Priority Date for Proceeds

Collateral is defined in section 1 to mean personal property that is subject to a security interest. Under section 28, a security interest in collateral that is dealt with or otherwise gives rise to proceeds extends to the proceeds. The result is that the residual priority rules set out in section 35(1) may apply in a contest between competing security interests in proceeds as well as in the original collateral. Section 35(3) is intended to make it clear that for the purposes of applying these priority rules, the time of registration, possession or (temporary) perfection of the security interest in the original collateral is also the time of registration, possession or perfection of its proceeds. A secured party, in other words, retains the same priority ranking in a contest for proceeds as it does the original collateral. Ontario s. 35(5) is the same.

Priority of Future Advances against Intervening Security Interests

It is commonplace, especially in commercial financing arrangements, for the secured loan to take the form of either a fluctuating credit arrangement or a series of installment advances rather than a single contemporaneous lump sum loan. Under the existing law, a secured party is entitled to "tack" any such future advances to its original advance provided the future advance arrangement was clearly contemplated in the security agreement. The future advances are not treated, in other words, as creating separate security interests but are permitted to relate back to the original security agreement. To that general rule, there exists one important exception: a secured party will be subordinated to the extent of any advances made after it has actual knowledge of an intervening security interest[2]. The justification for this rule may well have been the same one that inspired the common law prejudice against security in after-acquired property: it facilitated the debtor's freedom to procure subsequent financing from other sources should its needs require or circumstances change. Whatever other justifications may be mounted in favour of retaining the rule in the real property mortgage context, the PPSA's detailed priority code prescribing when a subsequent secured party can gain priority over an earlier one - whether absolutely or for subsequent advances - eliminates the need to undermine the first secured party's potential monopoly by a general prejudice against future advances. If subordination is desired, it can and should be arrived at by a subordination agreement between the senior and junior security interests. Accordingly, the PPSA retains the existing general rule on tacking but eliminates the exception in favour of intervening security interests. Under section 35(4), the priority that a security interest has under the general or residual rule stated in section 35(1) applies to all advances, including future advances.

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[1] See further commentary on section 19.

Priority of Future Advances against Intervening Execution Creditors

Under section 35(6), the security interest has priority over the interests of persons referred to in section 20(a) of the Act only to the extent of advance made before their interests arise and before the secured party acquires knowledge of their interests.

Why this exception?

Firstly, a security interest renders the collateral immune from the reach of the debtor's execution creditors only to the extent of the outstanding indebtedness. That is to say, a $1 debt on collateral with a value of $100 leaves $99 "equity" free for the execution creditors to attach. So much is recognized by the Rules of Court which provide a means by which execution creditors can execute on property subject to a security interest. But the existing law does not clarify what is to happen if after execution has been initiated, the secured party proceeds to make further advances. Section 35(6) of the PPSA provides a clear cut point for determining when the interests of the execution creditor prevail over the right of the secured party to tack.

Secondly, under the existing law, an execution creditor takes priority over a secured party holding a floating charge on the debtor's assets if the execution is completed before the security interest crystallises. The PPSA effectively eliminates the floating charge and generally permits a security interest to attach and take effect as from the moment of attachment. The rationale for the existing reluctance to admit a present attachment in the case of the floating charge was a concern to protect the interests of the debtor's judgment creditors while the business was still a going concern. But the secured party's vulnerability under a floating charge to execution creditors put it under pressure to crystallise the charge, close down the debtor's business prematurely and refuse to inject any more capital into the enterprise, once the execution creditors started to move. Section 35(6) represents a halfway measure. It allows the secured party to retain priority for advances made up to the point that it acquires knowledge of the interest of debtor's execution creditors but puts it at risk for any advances made after knowledge is acquired.

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[2] The rule was conceived and applied to real property mortgages in *Hopkinson v. Rolt* (1861) 9 HL Cas 514 and its applicability to chattel mortgages confirmed by *West v. Williams* [1899] 1 Ch 132 (CA). The rule applies to successive mortgages or charges on intangibles as well as chattels: *W H Fraser v. Imperial Bank of Canada* (1912) 47 SCR 313.

The Priority Consequences of a Lapsed Registration

If registration lapses, the new Ontario PPSA expressly states that the security interest may be reperfected by the registration of a fresh financing statement[3]. Although the other Acts do not contain any equivalent provision, there is clearly nothing to prevent any secured party, whether it happens to have previously registered or not, from registering a financing statement at any time.

What are the priority consequences of a lapse in registration that is followed by reregistration? As noted in the commentary accompanying section 23, perfected status at the relevant priority point rather than continuity of perfection from initial registration is ordinarily all that is relevant in a priority dispute with third party claimants who are not themselves secured creditors. Accordingly, if the lapsing secured party manages to reregister before bankruptcy or a seizure under execution or a transfer of the collateral intervenes, it will be no worse off than if the lapse had not occurred.

The priority consequences of reperfection following a lapse in registration are more complicated where the priority contest involves another secured party. The various versions of the PPSA offer the full spectrum of potential approaches to the problem.

The old Ontario PPSA offered a most generous measure of protection to the reperfecting creditor. Reregistration after lapse extended the effect of the original registration for a further three years except where the registration "prejudiced the rights of any person acquired by any act or thing done by him during the period that the security interest was unperfected" in which event, the registration was presumed not to have occurred for the purpose of obtaining such rights[4]. The new Ontario PPSA discards this rather cumbersome wording and replaces it with somewhat more straightforward language that may well offer even broader protection. Once reregistered, the lapsed interest is deemed to have been continuously perfected from the time of first perfection except that the reregistration is ineffective as against any person who acquired rights in the collateral during the period that the security interest was unperfected[5]. The old wording was sufficiently ambiguous to support a construction that subordinated the lapsing creditor as against a pre-lapse secured creditor to the extent of advances made by the latter during the lapse period[6]. It is at least unclear whether the new wording - by requiring that the third party seeking to be protected have acquired rights in the collateral during the lapse period rather than simply have committed a prejudicial act - is broad enough to accomplish the same result.

A solution at the other extreme is found in the Manitoba PPSA which does not provide any express protection to the lapsing creditor who later reperfects. As a result, its perfected status will date only from reperfection with a consequent loss of priority as against pre-lapse secured parties[7].

(continued)
More recently, see *Siebe Gorman & Co Ltd v. Barclay's Bank Ltd* [1979] 2 Ll Rep 141.

[3] Ont s. 52(2)

[4] s. 53(1)(c). Otherwise, the secured party is returned to its pre-lapse priority postion: *Weber v. Royal Bank of Canada* (1984) 4 PPSAC 242. Intervening unsecured creditors whose rights had not yet crystallized within the meaning of section 20 of the Act remain subordinated to the lapsing creditor once reregistration is effected: *Re Yustin Construction Ltd* (1986) 5 PPSAC 154.

[5] section 30(6)

[6] *Re Triaad Financial Services* (1979) 27 OR 2d (Ont CA) affirming 1 PPSAC 44 (Ont SC), leave to appeal to SCC dismissed. And see Jacob Ziegel's commentary on the case: "The Quickening Pace of Jurisprudence under the Ontario Personal Property Security Act" (1979-80) 4 CBLJ 54 at 84 et seq.

[7] See *Fotti v 777 Management Incorporated* (1981) 2 PPSAC 32 (Man QB) where the

The Saskatchewan PPSA adopts something of an in-between position which succeeds in paying heed to the arguments of the opposing camps on the issue. If the secured party reregisters its security interest within thirty days after the lapse, the prior lapse does not affect the priority status of the security interest in relation to competing interests in the collateral which arose prior to the lapse or discharge except insofar as subsequent advances are made or contracted for after the lapse and prior to the reregistration[8]. But if the thirty day period expires without reregistration having taken place, the non-complying creditor's pre-lapse priority ranking is irrevocably lost. While it may still reregister or otherwise reperfect, its perfected status for priority purposes will date from the time of reperfection rather than the original registration[9].

Saskatchewan's compromise position was adopted in section 35(6) of the Western Model PPSA proposed for New Brunswick.

Maintaining Perfection after a Lapse due to an Erroneous or Unauthorized Discharge

A security interest will also become unperfected if registration is discharged. In the vast majority of cases, of course, the discharge will simply reflect the fact that the loan is liquidated. The discharge may, however, have been effected without the authority of the secured party or as a result of error or even fraud. The old Ontario Act did not provide any mechanism for the secured party to reinstate its security interest following an inadvertent discharge as one secured party learned too late[10]. When a bank discovered, some two months after the fact, that its credit officer had erroneously registered a discharge, it promptly registered a financing change statement with the intention of reinstating the original registration. Within a matter of hours, the debtor made an assignment in bankruptcy. It was held that the discharge had caused the security interest to become unperfected. Furthermore, the attempt at reinstatement failed because it did not fall within the circumstances for which a financing change statement could be used. Having become unperfected, the security interest could only be perfected again by an original perfection method. In the result, then, the bank's interest was subordinated to that of the trustee.

The Saskatchewan PPSA expressly addresses the problem of a premature discharge due to error or fraud or lack of authority and resolves it in the same manner as a inadvertent lapse caused by the expiry of the registration life of a financing statement: the secured party is given a 30 day period to reregister in which event the lapse or discharge does not affect the priority status of the security interest as against pre-lapse security interests except for advances made during the lapse period[11]. The temporary protection afforded by this provision is intended to work in tandem with the fact that when a discharge is filed under the Saskatchewan Act, the secured party is notified forthwith and the 30 day period is presumably sufficient to give it time to reinstate its registration[12]. Section 35(7) of the Western Model

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(continued)
secured party conceded without argument that the effect of its lapsed registration meant it now ranked junior to other secured parties over whom it had enjoyed priority prior to the lapse.

[8] section 35(5)

[9] Sask s. 35(2). Where there is a period, after the registration of a security interest, the taking of possession of the collateral by the secured party or the perfection of the security interest, during which there is no registration of the security interest, possession of the collateral or perfection of the security interest, priority of the security interest dates from the time when it is reregistered, reperfected or from the time the secured party retakes possession.

[10] *Re Dante Boutique Shoes* (1982) 2 PPSAC 27

[11] Section 35(5)

provides the same protection for secured parties against the risk of erroneous or unauthorized discharges.

Actual Knowledge or Notice Irrelevant to Priority

In applying the residual first-in-time priority rule of PPSA section 35, knowledge or notice of the existence of another security interest in the same collateral does not affect the priority determination. In enacting the PPSA, the legislature intended to provide a code whereby the priority of security interests in personal property could be determined and enforced with certainty[13].

(continued)

[12] Ziegel and Cumming, *op. cit.*, p. 288

[13] See further the commentary on section 19. And note *National Trailer Convoy of Canada Ltd v Bank of Montreal* (1980) 1 PPSAC 87 (Ont HC) at 94.

SECTION 36

SECURITY INTERESTS IN FIXTURES

36(1) In this section, "secured party" includes a receiver.

36(2) Except as provided in this section and in section 30, a security interest in goods that attaches before or at the time the goods become fixtures has priority with respect to the goods over a claim to the goods made by a person with an interest in the land.

36(3) A security interest referred to in subsection (2) is subordinate to the interest of

- (a) a person who acquires for value an interest in the land after the goods become fixtures including an assignee for value of a person with an interest in the land at the time the goods become fixtures, and
- (b) any person with a registered mortgage of the land who, after the goods become fixtures,
    - (i) makes an advance under the mortgage, but only with respect to such advance, or
    - (ii) obtains an order for sale or foreclosure,

without fraud and before the security interest is registered in accordance with section 49.

36(4) A security interest in goods that attaches after the goods become fixtures is subordinate to the interest of a person who

- (a) has an interest in the land at the time the goods become fixtures and who
    - (i) has not consented to the security interest,
    - (ii) has not disclaimed an interest in the goods or fixtures,
    - (iii) has not entered into an agreement under which a person is entitled to remove the goods, or
    - (iv) is not otherwise precluded from preventing the debtor from removing the goods, or
- (b) acquires an interest in the land after the goods become fixtures if the interest is acquired without fraud and before the security interest in the goods is registered in accordance with section 49.

36(5) A security interest referred to in subsection (2) or (4) is subordinate to is subordinate to the interest of a creditor of the debtor who causes a memorial of judgment affecting the real property to be registered in the appropriate land registry or land titles office under the *Memorials and Executions Act* before the security interest is registered in accordance with section 49.

36(6) The interest of a creditor or a sheriff referred to in subsection (5) does not take priority over a purchase money security interest in goods a notice of which is filed in accordance with section 49 not later than 15 days after the goods are affixed to the land.

36(7) A secured party who, under this Act, has the right to remove goods from land shall exercise this right of removal in a manner that causes no greater damage or injury to the land and to other property situated on it or that puts the occupier of the land to greater inconvenience than is necessarily incidental to the removal of the goods.

36(8) A person, other than the debtor, who has an interest in the land at the time the goods subject to the security interest are affixed to the land is entitled to reimbursement for any damages to the interest of the person in the land caused during the removal of the goods, but is not entitled to reimbursement for diminution in the value of the land caused by the absence of the goods removed or by the necessity of replacement.

36(9) The person entitled to reimbursement under subsection (8) may refuse permission to remove the goods until the secured party has given adequate security for reimbursement.

36(10) The secured party may apply to a court for one or more of the following orders:

(a) determining the person entitled to reimbursement under this section,

(b) determining the amount and kind of security to be provided by the secured party,

(c) prescribing the depository for the security,

(d) authorizing the removal of the goods without the provision of security for reimbursement under subsection (9).

36(11) A person having an interest in the land that is subordinate to a security interest as provided in this section may, before the goods have been removed form the land by the secured party, retain the goods upon payment to the secured party of the lesser of the following:

(a) the amount secured by the security interest having priority over the interest, and

(b) the market value of the goods if the goods were removed from the land.

36(12) The secured party who has a right to remove goods from land shall give to each person, who appears by the records of the appropriate land registry office or land titles office to have an interest in the land, a notice of the intention of the secured party to remove the goods and the notice shall contain

(a) the name and address of the secured party,

(b) a description of the goods to be removed,

(c) the amount required to satisfy the obligation secured by the security interest,

(d) the market value of the goods,

(e) a description of the land to which the goods are affixed, and

(f) a statement of intention to remove the goods,

unless the amount referred to in subsection (11) is paid on or before a specified date that is not less than 15 days after the notice is given in accordance with subsection (12).

36(13) **A notice referred to in subsection (12) shall be given at least 15 days before removal of the goods and may be given in accordance with section 69 or by registered mail addressed to the post office address of the person to be notified as it appears in the records of the appropriate land registry office.**

36(14) **A person entitled to receive a notice under subsection (13) may apply to a court for an order postponing removal of the goods from the land.**

COMMENTARY

Purpose and Scope

Goods that are attached to the realty in such a way as to become "fixtures" change their legal identity to real property. Nonetheless, fixtures begin life as goods, retain their physical character as goods even after attachment and may be reconverted to the state of personal property by being unfixed from the realty. This makes personal property security the more appropriate and practical choice for a secured party who wishes merely to finance the purchase of a chattel to be attached to the realty or to make an advance against the security of an existing fixture. If fixtures financiers were forced instead to take and register a real property mortgage in order to secure their interest in the goods, independent fixtures financing would effectively come to an end.

Although the PPSA does not generally apply to security interests in land[1], it recognizes the unique demands of fixtures financing. Accordingly, "fixtures" are included in the definition of "goods" in section 1 in which a "security interest" subject to the PPSA may be taken and perfected.

The same PPSA attachment, perfection and priority rules that apply to security interests in goods can be and will be applied to regulate the personal property aspects of fixtures financing. Special rules are needed, however, should the claim of the fixtures financier under personal property security law comes into competition with the claims of third parties who acquire or who already have an interest in the land to which the fixtures are attached. The mutual exclusivity of the real property and personal property legal worlds means that such priority contests cannot be resolved within the perfection and priority structure of either alone. A means of bridging the two worlds is needed. It is to that end that section 36 specifies when a fixtures financier must register its interest against the land to which the fixture is or will be attached in order to gain or maintain priority against third party interests in the land.

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[1] Section 4(e)

Where the fixtures financier has priority, enforcement of its security interest requires unfixing the collateral, a process that may cause some incidental damage to other realty. Accordingly, section 36 also addresses the manner of enforcement, the circumstances in which the fixtures financier will be obligated to compensate third party interests for any incidental damage to the realty and the circumstances in which subordinate realty interests will be entitled to retain the goods *in situ* by paying out the fixtures interest.

The section 36 priority regime draws a basic distinction between the priority of a security interest in fixtures that attaches before the goods become fixtures and one that attaches after they become fixtures. The fact that attachment, not perfection, of the security interest is the relevant event under section 36 should not be interpreted as a license to fixtures financiers to dispense with the need to perfect their security interests by registration in the PPSA registry. On the contrary, perfection under the PPSA will still be critical in a priority contest between the fixtures financier and competing personal property security interests taken in the same goods as well as the debtor's trustee in bankruptcy and execution creditors. In other words, section 36 is relevant only in a priority contest between a PPSA fixtures financier and third party realty interests. If there are no competing realty interests in the picture, the real property aspect of fixtures security may be ignored.

"Fixtures" and "Building Materials"

The term "fixtures" is sometimes used loosely to encompass all chattels that are annexed to realty. But strictly speaking, the term means more or less distinct articles affixed to the freehold as accessory to its use[2]. It does not include goods that are so intimately built into a building that their distinct chattel personality becomes irretrievable without the partial removal or destruction of the building itself. The classic instance is building materials - lumber and nails or bricks and mortar, for instance - erected into a house or other structure. Here, common sense and commercial convenience tell us that the goods should be incapable of reception by the original chattel interest. The common law policy to this effect[3] is codified and clarified in the existing *Conditional Sales Acts*[4] and has been carried over in turn to the PPSA.

"Building materials" are expressly excluded from the definition of "fixtures" in section 1 of the Act and therefore from the scope of application of section 36. Accordingly, neither the PPSA in general nor section 36 in particular will apply to protect a financier of "building materials" that have been incorporated into the realty. The relegation of building materials to real property security law ensures that construction mortgagees are protected against the risk of removal of some essential portion of the realty by materials suppliers and financiers. They must instead seek protection under the *Mechanics Lien Act* or take and register real property security.

Under part (a) of the definition in section 1, the test for determining whether goods constitute "building materials" is whether their removal from a building would necessarily involve the removal or destruction of some other part of the building, thereby causing substantial damage to the building apart, of course, from the loss of value to the building resulting from the removal of the goods themselves. This wording parallels the wording of the definition of "building materials" in the existing *Conditional Sales Act* and the jurisprudence on the meaning of the concept in that context will continue to be helpful.

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[2] See the cases cited by Manning, *Annotation, Fixtures* [1927] 1 DLR 289-356 at 294.

[3] See, for instance, *Hall Mfg Co v. Hazlitt* 11 AR (Ont) 749 at 750; *Gough v Wood & Co* [1894] 1 QB 713 at 719.

[4] See *CSA* section 1, definition of "building materials". See also *Collis v Carew Lbr*

Part (b) of the definition introduces a new element in the legislative definition of "building materials". Heating, air conditioning and conveyancing devices and machinery installed for use in carrying on an activity are expressly excluded. It was thought that under existing commercial practice, these items are or may be the proper subject of a separate purchase money security interest subject to personal property security law.

Fixtures and Goods

A characterization at the opposite extreme from "building materials" is possible where the chattels are so tenuously attached to the land that they still retain their character as personal property. If this is indeed the case, then the relations between secured party and debtor and as against third parties are regulated exclusively by personal property security law and no priority conflict with land interests can arise. Mutual exclusivity prevails.

"Fixtures"

Except for the express exclusion of "building materials", the term "fixtures" is left undefined in the PPSA. Whether and when any other item of collateral should be classified as personalty, realty or a true fixture so as to bring into play section 36 is left to the courts for determination. In making that characterization, the pre-PPSA case law on the meaning of "fixtures" will remain relevant.

In general, the caselaw establishes that what is a fixture depends primarily on the degree of annexation and the object of annexation. However, in borderline cases, characterization has proved to be very much a functional exercise related to the intention of the parties, their relationship and the interplay of the perfection, priority and enforcement rules that will apply depending on the result of the characterization exercise. Because the jurisprudence has been heavily result-oriented, the various cases cannot all be reconciled and the particular regime established by section 36 will no doubt itself influence the characterization for PPSA purposes.

Priority between Pre-Affixation Fixtures Interests and Subsequent Realty Interests

In a contest between a fixtures interest which attached before the goods became fixtures and a subsequent realty interest, early Canadian legal opinion was sympathetic to the fixtures financier, at least in Ontario[5]. But in 1897, the English Court of Appeal put paid to

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Co [1930] 4 DLR 996 (Ont CA) at 999.

[5] Where the fixtures security agreement took the form of a conditional sales contract, the seller's retention of title, at least if coupled with a contractual right to retake possession of the collateral on a default, was interpreted to mean that the chattels never lost their identity as goods notwithstanding subsequent attachment to the realty. Consequently, conditional sellers routinely prevailed over competing subsequent third party realty interests: *Polson v. Deeger* (1886) 12 OR 275 at 281, *Hall Mfg Co v. Hazlitt* 11 AR (Ont) 749, *Howell v. Listowel Rink & Park Co* 13 OR 476; and see Manning, *Annotation, Fixtures* [1927] 1 DLR 289-356 at 350 *et seq.*

Where the fixtures interest took the form of a chattel mortgage on goods not yet attached to the realty, the law seems to have been less settled.

On the early and existing law generally, see Manning, "Annotation, Fixtures" [1927] the evident colonial reluctance to prefer the "landed" in fixtures cases[6], ruling in *Hodson v. Gorringe*[7] that a hire purchase agreement giving the vendor the right to unfix the goods on a default was unenforceable against subsequent purchasers and mortgagees of the realty without notice[8].

In Canada, it seems to have been generally accepted after *Hobson v. Gorringe* that a chattel mortgage on fixtures, although duly filed under the *Bills of Sale Act*, did not prevail as against a subsequent purchaser or mortgagee of the land under a registered conveyance without notice of the prior chattel mortgage[9].

But in relation to conditional sales, the Ontario legislature intervened "for the purpose of preventing the law as laid down in England prevailing in [that] Province"[10]. The *Conditional Sales Act* was amended to provide that goods later affixed to the realty would nonetheless remain subject to the title of the conditional seller or lender but with the right to the owner or any purchaser or mortgagee of the realty to retain the goods upon payment of the amount due to the conditional seller[11]. The Uniformity Commissioners included a similar provision in the 1922 *Uniform Conditional Sales Act* which was adopted in most other provinces including New Brunswick.

At first it was thought that the new provision gave conditional sellers and lenders "a right in the nature of an easement or a covenant running with the land, the burden of which [would] attach to the land even in the hands of a subsequent purchaser or mortgagee, and notice to him was not necessary to create the right"[12]. However, the legislation did not ex-

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1 DLR 289-356, Campbell, "Fixtures and Improvements including the Rights of Conditional Vendors and Chattel Mortgagees" (1965) LSUC Special Lectures, Goode and Ziegel, Hire-Purchase and Conditional Sale (1965) at 173-78, Tremeear, A Treatise on the Canadian Law of Conditional Sales of Chattels and of Chattel Liens (1899) at 116-19.

[6] That there existed a general colonial reluctance to show preference to the "landed" in fixtures cases is reflected in the fact that "in Canada, the judges have been more in favour of the tenant than in the English cases": Campbell, "Fixtures and Improvements including the Rights of Conditional Vendors and Chattel Mortgagees" (1965) LSUC Special Lectures, at 47.

[7] (1897) 1 Ch 182. And see subsequently *Reynolds v. Ashby* [1904] AC 466.

[8] The situation was analagous to the right of a tenant to remove fixtures put in during the tenancy for the purposes of trade or ornamentation or domestic convenience. The common law divided tenant's fixtures into a primary or irremovable class and a secondary or removable class that included fixtures put in for the purpose of trade or domestic convenience or ornament. As against the landlord, fixtures falling into the secondary class could be returned to the state of chattels again by removing them from the realty if the removal could be effected without injury to the realty. Until severed, tenant's fixtures are part of the realty. Likewise, the chattels sold under the hire purchase agreement became fixtures upon attachment subject only to the secured party's contractual right under the security agreement to retake possession on a default. Since that right was personal and contractual and not *real* and proprietary, it was unenforceable against subsequent purchasers and mortgagees of the land without notice.

[9] See Manning, "Annotation, Fixtures" [1927] 1 DLR 289-356 at 349 and see *Ellis v. Glover & Hobson Limited* [1908] 1 KB 388 (CA). But see *Barron & O'Brien on Chattel Mortgages and Bills of Sale*, 3d ed., Toronto, 1927 at 23.

[10] *Liquid Carbonic Co. Ltd. v. Rountree* [1924] 1 DLR 1092 (Ont CA) at 1096 per Middleton J. See also *Collis v. Carew Lbr. Co* [1930] 4 DLR 998 (Ont CA) at 998 per Middleton J.

[11] SO 60 Vict c. 14 s. 80, amending 51 Vict c. 19

[12] Note on "Fixtures", CLJ 412 at 412.

pressly exclude the application of the *Land Titles Act* or the *Registry Act* to fixtures and under both acts interests in realty which were not registered thereunder were subordinated to subsequent purchasers and mortgagees of the realty whose conveyances were registered. In *Hoppe* v. *Manners*[13], the Ontario Court of Appeal ruled that the policy underlying the land registry acts would be entirely undermined if purchasers of the realty were exposed to the risk that some essential portion of the realty was subject to a right of removal by a secured party whose interest would not be disclosed on the realty records. Accordingly, the conditional seller's title was held to be ineffective, notwithstanding registration under the *Conditional Sales Act*, against a subsequent purchaser of the realty *sans* registration of the agreement or any caution against the land.

The dual registration requirement imposed by *Hoppe v. Manners* was subsequently codified in the *Uniform Conditional Sales Act* and adopted in turn by most provinces, including New Brunswick. The New Brunswick *Conditional Sales Act* thus requires conditional sellers to also register a copy of the conditional sales agreement in the Registry Office of the county in which the land to which the goods sold are to be attached if they wish to protect their title against subsequent purchasers and mortgagees of the realty[14].

The PPSA essentially restates the *Conditional Sales Act* solution, expanded to encompass any security interest taken in fixtures before they are attached to the realty whether it takes the form of a conditional sale or some other form of security. Section 36(3)(a) provides that a security interest in goods that attaches before or at the time the goods become fixtures is subordinated to interests in the land acquired for value without knowledge after the goods become fixtures and before notice of the fixtures interest is registered against the land pursuant to PPSA section 49[15].

Priority between Pre-Affixation Fixtures Interests and Prior Realty Interests

Under the land registry legislation, a failure to register generally subordinates the unregistered interest only as against subsequent transferees. It follows that under the existing law, a conditional seller of goods that are to be affixed to the land is not required to register in the land registry system in order to maintain priority over a *prior* interest in the realty[16].

The PPSA adopts the same approach. Pursuant to section 36(2), a security interest in goods which attaches before or at the time the goods become fixtures, has priority over a claim to the goods made by a person with an existing interest in the land.

However, an existing real property mortgagee who advances funds after the goods are attached may well rely in making the advance on the addition of new value to the realty that is represented by the fixture. To the extent of the new advance, the mortgagee's reliance interest requires similar protection to that awarded to subsequent purchasers and mortgagees of the realty, a point recognized both in the existing law[17] and under the PPSA. Section

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[13] [1931] 2 DLR 253

[14] CSA s. 17(4)

[15] As to registering notice of a fixtures interest in the land registry or land titles office, as the case may be, see further the commentary on PPSA section 49.

[16] *Warner v. Foster* [1934] 3 DLR 665 (Ont CA). And see *Montreal Trust v. Goldaire Rentals* (1966) 59 DLR (2d) 338 (Ont HC).

[17] In *California Well Bed v. Prudential* [1935] OR 519, it was decided that the date of registration of the land mortgage rather than the date of advances governed whether the mortgage was prior or subsequent to a conditional sale of fixtures, notice of which was registered between advances. Consequently, the Ontario *Registry Act* did not give priority for advances made after the chattels were affixed to the realty but before the conditional sales agreement

36(3)(b)(i) subordinates the fixtures interest to the interest an existing mortgagee of the land who makes an advance under the mortgage after the goods become fixtures but before the fixtures interest is registered against the land pursuant to section 49. The priority is only to the extent of the new advance, however. Previous advances will still be subordinated.

Section 36(3)(b)(ii) subordinates the fixtures interest to the interest of a prior mortgagee of the land in one other case: where an existing mortgagee has pursued enforcement to the stage of obtaining an order for sale or foreclosure of the land after the goods become fixtures but before the fixtures interest is registered under section 49. Without an express priority over the fixtures interest, the mortgagee would be unable to determine whether or not the fixtures were to be considered as part of the sold or foreclosed land.

Priority between Post-Affixation Fixtures Interests and Prior and Subsequent Realty Interests

Landowners and tenants may sometimes wish to use goods that are already affixed to the realty as independent collateral separate and apart from the realty to which they are attached. Indeed, this will be the debtor's only option where it does not own the realty.

The existing law contemplates the taking of security against *de facto* fixtures. Under the *Bills of Sale Act*, for instance, "chattels" are defined for the purposes of the Act to expressly include fixtures "when separately assigned or charged" and to expressly exclude fixtures "when assigned together with a freehold or leasehold interest in any land or building to which they are affixed". It has also been suggested that section 14 of the *Act* - which provides that the Act extends to a mortgage even where the goods are not fit for delivery at the time - is wide enough to include a mortgage of goods already affixed to the realty[18].

However, the effectiveness of a chattel mortgage on fixtures as against the debtor and as against third party realty interests are two separate things. The *Bills of Sale Act* does not address the latter context at all. On the contrary, by excluding fixtures from the concept of chattels where assigned as part of the freehold, the *Act* confirms the ability of realty interests to lay a competing claim to the chattels under a sale or mortgage of the land as the case might be, leaving it to the courts to determine priority. And in the case of a chattel mortgage on *de facto* fixtures, there is in fact little sympathy for the fixtures mortgagee "who has himself to thank if he fails to obtain the benefit of his contract for he knows that the articles are affixed and should be bound to make inquiries and to complete whatever arrangements may be necessary to enable his claim to be justified".

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was registered. That result was thought offensive because the mortgagee may have relied on the added value to the realty represented by the fixtures in making the advance. Accordingly, the Ontario *Conditional Sales Act* was amended to give priority to an existing registered mortgage or charge on realty for all payments or advances made thereunder *after* the goods became affixed to the realty and *before* registration of the conditional sales contract in the land registry *Conditional Sales Act* RSO 1970, c. 75, section 14(4), first incorporated in the Act in 1938. The New Brunswick *CSA* does not contain a similar amendment. However, the authority of *California Well Bed v. Prudential* is dubious as there is caselaw to the effect that prior or subsequent status should be decided according to when advances are made because that the advance is the real act of reliance.

[18] Campbell, "Fixtures and Improvements including the Rights of Conditional Vendors and Chattel Mortgagees" (1965) LSUC Special Lectures, at 63.

While the cases are by no means all reconcilable, it is fairly clear that under the existing law a mortgage of *de facto* fixtures, although duly filed under the *Bills of Sale* Act, will not prevail as against a subsequent purchaser or mortgagee of the land without knowledge of the prior chattel mortgage unless it is also registered against the land[19]. This is clearly the result under the PPSA. Under section 34(4)(b), a security interest in fixtures that attaches after the goods become fixtures is subordinate to the interest of a person who acquires an interest in the land without knowledge of the fixtures interest and before it is registered against the land pursuant to section 49. The reason for subordination is the same here as in the case of pre-affixation fixtures interests. A subsequent purchaser or mortgagee of land should be entitled to rely on the doctrine that fixtures normally pass as part of a sale or mortgage of land unless a search of the realty records discloses the fixtures interest.

But in contrast to the position in relation to pre-affixation security interests, a security interest that attaches *after* the goods become fixtures is also subordinated by section 36(4)(a) to prior interests in the realty. Fixtures constitute part of the freehold and a debtor ought not to be able to dilute the property rights of a prior interest by subsequently creating competing interests in part of that realty to take priority over the existing interest.

However, the *prima facie* priority enjoyed by persons with an existing realty interest is displaced if they consented to the fixtures security interest or disclaimed an interest in the goods or fixtures (as where their conveyance expressly excluded fixtures from the grant of realty). Priority is also made subject to any agreement entered into by the realty interest entitling a person to remove the goods and the realty interest must not be otherwise precluded from preventing the debtor from removing the goods. A prime instance in which the realty interest would be so precluded is the common law right of a tenant to remove fixtures put in for the purposes of trade or ornamentation or domestic convenience during the course of the tenancy. The caveats on the priority of existing realty interests are designed to ensure that the fixtures interest succeeds to the right of the tenant as against the landlord in this regard.

Duty to Reimburse for Removal Damage

Where a fixtures financier becomes entitled to enforce its security by taking possession of the collateral, the process of unfixing the fixtures from the realty will commonly involve at least some incidental damage to the realty. Since this is one of the inherent risks in fixtures financing, there is no inequity in letting the damage lie where it falls where the debtor has the sole interest in the realty. So too as against third parties who acquired their interest in the realty after the goods became fixtures and after notice of the fixtures security was registered in the realty records.

But the equities are quite different as against third parties who already had an interest in the realty at the time the goods became fixtures. Since the fixtures financing occurred after they had acquired their interest, they cannot be presumed to have given their *a priori* consent to the risk of damage. Existing conditional sales legislation does not expressly protect them against this risk but at common law, even where a person is entitled to remove articles affixed, he or she may be liable in damages for disturbing the freehold[20]. Section 36(8) is intended to codify and refine this policy and imposes an obligation on the fixtures financier to reimburse any person, other than the debtor, who had an interest in the realty at the time the goods became fixtures for any incidental damage caused to the realty by the removal operation.

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[19] *Bacon v Rice Lewis* 33 CLJ 680; *cf.* Barron & O'Brien on Chattel Mortgages and Bills of Sale, 3d ed., Toronto (1927) at 23.

[20] Manning, "Annotation, Fixtures" [1927] 1 DLR 289-356 at 355 citing *Markle v.*

The obligation of reimbursement imposed by section 36(8) on the fixtures financing has a somewhat paradoxical effect. On the one hand, it should make fixtures financing somewhat more accessible in that it removes one temptation to classify goods attached to the land as realty rather than a true fixture simply because their removal may cause material injury to the property. On the other hand, the greater the degree of the contemplated annexation of the property to the realty, the greater the potential reimbursement obligation if there are third party realty interests already in the picture and the greater the unwillingness of a fixtures financier to extend financing.

Right of Subordinated Realty Interest to Retain Goods on Payment of Outstanding Balance to the Fixtures Interest

By their very nature, fixtures are generally worth more *in situ* than as "used goods" after severance especially since they may have been custom fitted to the needs or aesthetics of the particular realty. Accordingly, those with a subordinate interest in the realty may prefer to pay off the fixtures financier rather than allow repossession to take place and then have to go to the inconvenience and expense of locating and purchasing a suitable replacement in order to bring the market value of the property back up to par.

The existing conditional sales law recognizes this concern and requires conditional vendors to give advance notice of their intention to repossess a fixture to all registered interests in the realty[21].

The same policy has been carried over the PPSA. Under section 36(12), the fixtures interest must give notice of an intention to remove the goods from the land to all persons who appear by the records of the appropriate land registry or land titles office to have an interest in the land.

However, the Western Model PPSA proposed for New Brunswick parts company from both the existing law and the Ontario PPSA on the issue of what subordinate interests in the realty must pay out to the fixtures interest with priority in order to retain the fixtures *in situ*. The existing law requires that the fixtures financier be paid out the total amount owing in respect of the fixtures interest[22] and the Ontario PPSA retains the same approach. But under section 36(11) of the Western Model PPSA proposed for New Brunswick, subordinate realty interests may retain the goods *in situ* on payment of the *lesser* of the amount secured by the fixtures interest having priority and the market value of the goods.

The reason for the change is that the existing approach fails to take into account the fact that the economic value to the fixtures interest of its right of enforcement is limited to the value of the collateral. That is to say, seizing and selling the collateral does not ensure payment in full for the secured party and any difference between the proceeds realized and the amount still owing on the secured loan can be made up only in a deficiency action against the debtor personally. Thus, requiring subordinate realty interests to pay the fixtures financier the full amount secured in order to retain the goods *in situ* requires them in effect to take on the debtor's personal deficiency obligation. There is no reason why the secured party should gain a windfall advantage through the exercise of its remedy of repossession or should

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Houck (1860) 19 UCQB 164.

[21] *CSA* section 17(8). However, it seems that under the former Ontario practice at any rate, the obligation to give notice was generally ignored. The practice was for the conditional vendor to go and unfix the fixtures and if the realty interests then voiced a complaint, to give them the opportunity to pay up the balance and refix the fixtures: Campbell, "Fixtures and Improvements including the Rights of Conditional Vendors and Chattel Mortgagees", (1965) LSUC Special Lectures at 58-59.

[22] *CSA*, section 17(12) and Ontario PPSA, section 34(7).

not remain subject to the ordinary limitations of its enforcement rights simply because for other reasons it is thought compelling that third party realty interests should be allowed to have what amounts to a right of first refusal on any proposed seizure and sale of the collateral.

Indeed, the existing approach is economically wasteful. Especially in purchase money financing situations, there is apt to be a great discrepancy between the amount still owing on the loan and the actual value of the collateral. Here the right of seizure and sale is a second rate remedy at best, valued more for its *in terrorarum* than its economic effect. Where this is the case, a fixtures financier is apt not to exercise the right of first refusal since it will be cheaper to obtain substitute used fixtures at their market value. Accordingly, the fixtures financier will be forced to seize and sell the collateral, the expenses of which will be added to the deficiency action against the debtor while the third party realty interests will have to go to the expense and inconvenience of locating substitute fixtures. In short, the existing policy benefits neither the debtor nor the fixtures financier nor subordinate realty interests.

Proposed Variation to the Western Model PPSA

As presently drafted, section 36 of the Western Model PPSA codifies existing policy and subordinates prior interests in the land to a security interest taken in goods before they are attached to the realty, regardless of whether or not the fixtures interest is ever registered against the land. The approach is compatible with the real property rules governing the effect of a failure to register an interest in land under which the unregistered interest is subordinated only as against subsequent interests in the land.

However, the real property policy on the effect of a failure to register conflicts with the PPSA policy on the effect of non perfection. Under the PPSA, an unperfected security interest is subordinated as against all other perfected security interests in the same collateral, *regardless* of whether they are prior or subsequent. However, PMSI financing is an exception. A PMSI has a superpriority over even prior perfected security interests in the debtor's after-acquired property on the same theory that a PPSA security interest in goods that attaches before they are affixed to the realty has priority over prior realty interests notwithstanding that the fixtures would otherwise form part of their realty interest under real property law. Giving a superpriority to the PMSI or fixtures financier ensures the continued supply of purchase money financing. There is no unfairness to prior PPSA security interests or prior interests in the realty since it was the PMSI or fixtures financier's funds which enabled the debtor to acquire the collateral.

However, in the case of a PMSI, the purchase money financier must register within fifteen days after the collateral is delivered to the possession of the debtor in order to maintain superpriority. Failure to register within the prescribed time period causes the PMSI to lose its special preference and it falls back into the embrace of the general first to file rule.

UCC article 9-313 extends the approach taken to PMSI superpriority as against prior personal property security interests to fixtures superpriority as against prior realty interests To maintain priority as against a prior encumbrancer or owner of the land, the fixtures financier must register the interest against the land before the goods become fixtures or within 10 days thereafter. Failure to register within the prescribed period results in subordination of the fixtures interest to the prior realty interests.

A proposal will be made to the Canadian Conference on Personal Property Security Law to amend section 36 of the Western Model PPSA so as to likewise require a fixtures financier to register against the land before the fixtures are attached thereto or within 15 days thereafter in order to maintain priority as against prior interests in the realty.

A registration requirement is more compatible with the philosophy underpinning purchase money super priority and pre-affixation fixtures interest superpriority.

It would also avoid or at least minimize the potential for circular priority problems inherent in the present approach. Suppose SP1 holds a registered mortgage on realty under which $100,000 has been advanced. SP2 then supplies goods to D, the landowner, on purchase money financing terms and the goods are then affixed to the realty. SP3 then takes and registers a second mortgage against the land. SP2, the fixtures financier, registers under the PPSA but does not register notice of the fixtures interest against the land. Under PPSA section 36 as it is presently drafted, SP2, the fixtures financier, has priority over SP1, the prior mortgagee, but is subordinated to SP3, the subsequent mortgagee. However, SP1 has priority over SP3 under the first to register rule of the *Registry Act*. The result is a circular priority dilemma: the fixtures financier (SP2) has priority over the prior land mortgagee (SP1) under the PPSA who has priority over the subsequent land mortgagee (SP3) under the *Registry Act* who has priority over the fixtures financier(SP2) under the PPSA. But if section 36 were amended as proposed to require SP2 to register against the land in order to take priority as against both prior and subsequent realty interests, the PPSA and the *Registry Act* would yield the same result: the fixtures financier would be subordinated as against both realty mortgagees.

SECTION 37

SECURITY INTERESTS IN GROWING CROPS

37(1) **In this section, "secured party" includes a receiver.**

37(2) **Except as provided in this section, a security interest in crops has priority with respect to the crops over an interest in the crops claimed by a person with an interest in the land.**

37(3) **A security interest referred to in subsection (2) is subordinate to the interest of**

(a) **a person who acquires for value an interest in the land while the crops are growing crops, including an assignee for value of the interest of a person with an interest in the land while the crops are growing crops, and**

(b) **a person with a registered mortgage on the land who, after the crops become growing crops,**

(i) **makes an advance under the mortgage, but only with respect to the advance, or**

(ii) **obtains an order for sale or foreclosure,**

without fraud and before the security interest is registered in accordance with section 49.

37(4) **A security interest referred to in subsection (2) is subordinate to the interest of a creditor of the debtor who causes a memorial of judgment affecting the land to be registered in the appropriate land registry or land titles office under the *Memorial and Executions Act*.**

37(5) **The interest of a creditor referred to in subsection (4) does not take priority over a purchase money security interest in the crops, or a security interest in the crops referred to in subsection 34(8), a notice of which is registered in accordance with section 49 not later than 15 days after the time the security interest in the crops attaches.**

37(6) **Subsections 36(7) to (14) apply with any necessary modification to seizure and removal of growing crops from land.**

COMMENTARY

Like fixtures, crops occupy something of a borderland between the worlds of real and personal property and accordingly give rise to much the same problems of perfection and priority. On the one hand, a PPSA security interest is clearly the most appropriate mode of financing for landowners or tenants who wish to use their growing crops as independent collateral. On the other hand, the fact that crops begin life attached to realty creates the potential for competing claims between the crops financier and third parties with an interest in the realty. Owing to the close similarity between the issues involved, section 37 provides much the same regime for regulating personal property security interests in growing crops that section 36 does for fixtures. The commentary accompanying section 36 likewise applies *mutatis mutandis* to section 37[1].

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[1] See also sections 13(2)(a) and 34(8).

SECTION 38

SECURITY INTERESTS IN ACCESSIONS

38(1) In this section,

(a) "other goods" means goods to which an accession is installed or affixed,

(b) "the whole" means an accession and the goods to which the accession is installed or affixed,

(c) "secured party" includes a receiver.

38(2) Except as provided in this section and section 30, a security interest in goods that attaches before or at the time the goods become an accession has priority with respect to the goods over a claim to the goods as an accession made by a person with an interest in the whole.

38(3) A security interest referred to in subsection (2) is subordinate to the interest of

(a) a person who acquires for value an interest in the whole after the goods become an accession including an assignee for value of the interest of a person with an interest in the whole at the time the goods become an accession, and

(b) a person with a perfected security interest taken and perfected in the whole who

  (i) makes an advance under a security agreement after the goods become accessions, but only with respect to the advance, or

  (ii) acquires the right to retain the whole in satisfaction of the obligation secured,

without knowledge of the security interest in the accession and before it is perfected.

38(4) A security interest in goods that attaches after the goods become an accession is subordinate to the interest of a person who

(a) has an interest in the other goods at the time the goods become an accession and who

  (i) has not consented to the security interest,

  (ii) has not disclaimed an interest in the goods or accessions,

  (iii) has not entered into an agreement under which a person is entitled to remove the accession, or

  (iv) is not otherwise precluded from preventing the debtor form removing the accession, or

(b) acquires an interest in the whole after the goods become an accession, if such interest is acquired without knowledge and before the security interest in the accession is perfected.

38(5) A security interest referred to in subsections (2) and (4) is subordinate to the interest of a creditor or of a sheriff who has seized or caused the whole to be seized under legal process to enforce a judgment, if

(a) the seizure occurs under circumstances referred to in section 20, and

(b) the security interest is not perfected at the date of seizure.

38(6) The interest of a creditor or a sheriff referred to in subsection (5) does not take priority over a purchase money security interest in goods that is perfected not later than 15 days after the goods become an accession.

38(7) A secured party who, under this Act, has the right to remove accession goods from the whole shall exercise this right of removal in a manner that causes no greater damage or injury to the other goods or that puts the person in possession of the whole to no greater inconvenience that is necessarily incidental to the removal of the accession.

38(8) A person, other than the debtor, who has an interest in the whole at the time the goods subject to the security interest become an accession is entitled to reimbursement for any damages to the interest of such person in the whole caused during the removal of the accession, but is not entitled to reimbursement for diminution in the value of the whole caused by the absence of the accession or by the necessity of its replacement.

38(9) The person entitled to reimbursement as provided in subsection (8) may refuse permission to remove the accession until the secured party has given adequate security for the reimbursement.

38(10) The secured party may apply to a court for one or more of the following orders:

(a) determining the person entitled to reimbursement under this section,

(b) determining the amount and kind of security to be provided by the secured party,

(c) prescribing the depository for the security,

(d) authorizing the removal of the goods without the provision of security for reimbursement under subsection (9).

38(11) A person who has an interest in the whole that is subordinate to a security interest as provided in this section may, before the accession has been removed from the whole by the secured party, retain the accession on payment to the secured party of the lesser of the following:

(a) the amount secured by the security interest entitled to priority, and

(b) the market value of the accession if the accession were removed from the other goods.

38(12) The secured party who has a right to remove the accession from the whole shall give to each person

(a) who is known by the secured party to have an interest in the other goods or in the whole, and

(b) to each person who has registered a financing statement

(i) using the name of the debtor and referring to the other goods, or

(ii) according to the serial number of the other goods if they are goods defined in the regulations as serial numbered goods

a notice of the intention of the secured party to remove the accession and the notice shall contain

(c) the name and address of the secured party,

(d) a description of the goods to be removed,

(e) the amount required to satisfy the obligations secured by the security interest,

(f) the market value of the accession,

(g) a description of the other goods, and

(h) a statement of intention to remove the accession unless the amount referred to in subsection (11) is paid on or before a specified date that is not less than 15 days after the notice is given in accordance with subsection (13).

38(13) A notice referred to in subsection (12) shall be given at least 15 days before a removal of the accession and may be given in accordance with section 69 or by registered mail addressed to the address of the person to be notified as it appears on the financing statement.

38(14) A person entitled to receive a notice under subsection (12) may apply to a court for an order postponing removal of the accession.

COMMENTARY[1]

Purpose

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[1] The commentary on this section is not fully completed.

Goods are often an amalgam of a number of separate components that may require replacement or substitution as they wear out or become obsolete - new tires for a truck, for instance. As well, the value or utility of goods may often be enhanced by the addition of new components - a roof rack or trailer hitch, for instance. It is these added or substituted goods that are captured by the term "accessions", defined in section 1 to mean goods that are installed in or affixed to other goods.

The purpose of section 38 is to resolve priority conflicts between a secured party claiming a security interest in accessions and a person with an interest in the host goods. The considerations involved in resolving priority are similar to those that arise in a contest between a fixtures financier and a person with an interest in the realty to which the fixtures are attached but without the added complication that a realty and personalty interest are both involved. Not surprisingly, therefore, the priority rules set out in section 38 are practically a mirror image of those found in section 36 dealing with priority in fixtures.

Section 38 does not apply where goods subject to a security interest are so commingled with other goods in the manufacturing or assembly process that they lose their original distinct identity. Priority contests involving commingled goods are the subject of a separate priority regime: see commentary accompanying section 39.

PPSA Definition of "Accessions"

The common law doctrine of accession gives the property in goods installed in or affixed to other goods to the party with the interest in the whole. Various tests have been canvassed for determining when goods qualify as accessions so as to thus attract the right of accession[2]. Can the accessory chattels be removed without physical injury to the whole? Have the accessory chattels lost their identity in the installation process? How significant is the accession to the utility of the whole? What was the degree and the purpose of annexation?

It is not surprising that the common law has not been able to settle on a consistent legal definition of accessions. The purpose and effect of the characterization exercise is generally to determine priority in the accession in a contest between the party with the interest in the whole and the party with the interest in the accessions. Who should take priority depends on the relationship of the litigating parties and the character of their claims, not the abstract meaning of "accessions". It is the result-oriented nature of the characterization exercise, in other words, which explains why the concept of accessions can vary so from one case to the next[3].

PPSA section 38 establishes a priority and enforcement regime to regulate rights between a secured party claiming a security interest in accessions and a person claiming an interest in the goods in which the accessions are installed or to which they are affixed. Because the PPSA thus 'puts the cart back behind the horse', so to speak, it will no longer be necessary to manipulate the relative rights of the competing claimants to the accession by manipulating the legal meaning of "accession". Accordingly, the concept of "accessions" can be and is given its ordinary meaning under the PPSA. "Accessions" are defined in PPSA section 1 as simply "goods that are installed in or affixed to other goods", unembarrassed by any additional considerations having to do with severability, integral utility and the like[4].

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[2] *Industrial Acceptance Corp. v. Firestone Tire & Rubber Co.* (1968) 8 DLR (3d) 770 (Alta CA), reversed on appeal (1971) 17 DLR (3d) 229 (SCC)

[3] See the remarks of Laskin J to this effect in *Industrial Acceptance Corp. v. Firestone Tire & Rubber Co.* (1971) 17 DLR (3d) 229 (SCC)

[4] The definitions of "accessions" in the new Ontario PPSA and the Western Model are identical.

Priority

Section 38 draws a basic distinction between the priority of an accessions financier depending on whether the security interest attached before or after the goods became accessions. If before, the accessions financier enjoys priority over any claim made by a person with an interest in the host goods. The policy rationale for superpriority is the same one that supports superpriority for fixtures financiers who finance fixtures before they are attached to the realty and for holders of a PMSI. To subordinate the accessions financier to a person with a prior claim in the host goods who has not given value for the accessions would result in an unjustified windfall. The prior claimant cannot plead prejudice since they did not rely on any added value in the host goods represented by the accessions at the time they took their interest. It is these considerations which motivated the Supreme Court of Canada to rule that, as a matter of common law, a conditional seller of removable and identifiable accessory chattels takes priority over a prior title holder of the host chattel[5].

The superpriority accorded by section 38(1) is made subject to several exceptions in section 38(2), designed to ensure public notice of the security interest in the accessions to third parties who might otherwise act under the belief that the accessions formed part of the host goods after they are affixed. The accessions financier will be subordinated firstly to any person who acquires for value an interest in the host goods, including an assignee for value of a prior interest therein, without knowledge and before the security interest in the accessions is perfected; and secondly, to a person with a perfected security interest in the host goods to the extent of any advances made before the security interest in the accessions is perfected or who acquires the right to retain the whole in satisfaction of the secured obligation.

The accessions financiers interest is also made expressly subject in section 38(2) to the general purchaser for value without notice protection rules that are set out in section 30 of the Act.

Under section 38(2), the priority of the accessions financier is essentially reversed where the security interest is taken in the accessions after they are attached. Here, prior interests in the host chattels are entitled to rely on the general rule of property law that anything attached thereto forms part of it.

Just as with fixtures, the accessions financier must serve notice at least 15 days in advance of the fact of its intention to remove accessions.

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[5] *Industrial Acceptance Corp. v. Firestone Tire & Rubber Co.* (1971) 17 DLR 3d 229 (SCC) reversing (1968) 8 DLR 3d 770 (Alta AD).

NOTES

SECTION 39

SECURITY INTERESTS IN PROCESSED OR COMMINGLED GOODS

39(1) A perfected security interest in goods that subsequently become part of a product or mass continues in the product or mass if the goods are so manufactured, processed, assembled or commingled that their identity is lost in the product.

39(2) Subject to subsection (4) and (6), where more than one perfected security interest continues in the same product or mass under subsection (1), and each was a security interest in separate goods, the security interests are entitled to share in the product or mass according to the ratio that the obligation secured by each security interest bears to the sum of the obligations secured by all security interests.

39(3) For the purpose of section 35, perfection of a security interest in goods that subsequently become part of a product or mass is also perfection of the security interest in the product or mass.

39(4) For the purpose of subsection (2), the obligation secured by a security interest that continues in the product or mass under subsection (1) does not exceed the market value of the goods at the date that the goods become part of the product or mass.

39(5) Any priority that a perfected security interest that continues in the product or mass under subsection (1) has over a perfected security interest in the product or mass is limited to the value of the goods at the date that they became part of the product or mass.

39(6) A perfected purchase money security interest in goods that continues in the product or mass under subsection (1) has priority over a non-purchase money security interest

(a) in the goods that continues in the product or mass under subsection (1),

(b) in the product or mass, other than as inventory, given by the same debtor, and

(c) in the product or mass as inventory given by the same debtor if

  (i) the secured party with the purchase money security interest gives a notice to any secured party with the non-purchase money security interest in the product or mass, who registered a financing statement containing a description of collateral that includes the product or mass, before the identity of the goods is lost in the product or mass,

  (ii) the notice contains a statement that the person giving the notice has acquired or expects to acquire a purchase money security interest in goods supplied to the debtor as inventory, and

  (iii) the notice is given before the identity of the goods is lost in the product or mass.

39(7) **A notice referred to in subsection (6)(c) may be given in accordance with section 69 or by registered mail addressed to the person to be notified as it appears in the financing statement or security agreement referred to in subsection (6)(c).**

39(8) **This section does not apply to a security interest in an accession to which section 38 applies.**

COMMENTARY

Purpose and Scope

Both sections 38 and 39 deal with the perfection and priority issues that can arise when different collateral is combined. However, as section 39(7) states expressly, their scope of application is mutually exclusive. Section 38 applies to "accessions", *i.e.*, goods that are attached or affixed to other goods without a loss of identity. Tires remain identifiable as such, for instance, after affixation to a car. Section 39 applies when goods are commingled or processed in such a way as to lose their identity in the manufacturing or other process as where raw materials are assembled into finished goods or where components are fashioned into a machine. Gilmore's oft-quoted example is the case of a debtor who manufactures candy from sugar and chocolate financed from separate sources[1].

In order for section 39 to come into play, section 39(1) makes it clear the goods must be commingled or processed in such a way as to form part of a new "product or mass". Accordingly, collateral that does not merely lose its identity but is actually consumed or destroyed in the processing or commingling (*e.g.*, gasoline consumed in a motor vehicle or feed consumed by cattle[2]) falls outside the scope of section 39 and indeed section 38 for that matter.

Background and Evolution of PPSA Section 39

At common law, the courts were hesitant to award a secured party with a security interest in raw materials or components a corresponding right to trace into and assert a charge against the finished product or mass where the goods had lost their identity by the commingling or processing. In great part, this was because of the intractable problems they feared could and would arise in quantifying the proportion of the value of the manufactured product which the secured party could claim as properly attributable to its security interest in an individual ingredient[3].

The original UCC Article 9-315 resolved the debate in favour of permitting the security interest in the component collateral to continue into the finished product so long as it had been perfected prior to the commingling or processing. The problem of valuing the security interest was partially resolved by providing a rule of priority in the event that more than one security interest attached to the product or mass. The rule provided that the interests should rank equally but share ratably "according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total product or mass".

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[1] See generally, Grant Gilmore, *Security Interests in Personal Property* (1965) at pp 851-54

[2] See, for instance, *First National Bank of Brush v. Bostron* Colo App 1977, 564 P2d 964

[3] See, for instance, *Borden (U.K.) Ltd. v. Scottish Timber Products Ltd.* [1979] 3 WLR 672 (CA) per Bridge LJ at 683-4.

The article was left unchanged by the 1972 amendments to Article 9 and has been carried over virtually *verbatim* in both the old and the new Ontario PPSA. This was more a result, however, of reform inertia than implicit approval. As early as 1965, Grant Gilmore, an Associate Editor of Article 9 and a self-confessed "repentant draftsman" of Article 9-315 exposed the ambiguities and omissions inherent in the section and the conceptual acrobatics necessary to convert it into a workable solution[4].

As will become plain below, the drafters of the Western Model PPSA proposed for New Brunswick expanded the counterpart to UCC 9-315 - section 39 - in an attempt to redress the deficiencies in the original UCC model.

Priority Among Security Interests in Separate Component Collateral

Assuming the case is one falling within section 39, subsection (1) provides that a security interest in goods that is perfected before the goods are commingled or processed with other goods continues in the resulting product or mass.

Where more than one security interest is thus continued under section 39(1), section 39(2) provides that they are "entitled to share in the product or mass according to the ratio that the obligation secured by each security interest bears to the sum of the obligations secured by all security interests".

This formula is quite different from that found in the UCC Article 9-315 and the Ontario PPSA under which the interests are likewise ranked equally but shared "according to the ratio that the cost of the goods to which each interest originally attached bears to the cost of the total product or mass".

The difference in result in the two formulas and the reason for the change is best illustrated by the use of the same hypothetical that Professor Gilmore used to make his case for reform. Assume the following case:

> SP1 wholly finances the debtor's acquisition of sugar with an advance of $3,000 against a security interest in the sugar. SP2 wholly finances the same debtor's acquisition of chocolate with an advance of $5,000 against a security interest in the chocolate. The debtor combines the chocolate and the sugar to make candy. The total cost of the candy is $10,000 made up of the sugar at $3,000, the chocolate at $5,000 and the debtor's overhead and labour which is costed out at $2,000.

Applying the UCC formula, SP1 and SP2 will share in the proceeds of any realization against the final product in a ratio of 3/10 and 5/10 respectively. If the proceeds equate to the cost of the candy, each will be repaid the amount of their advance in full with a $2,000 unsecured residue. But if the proceeds amount to less than cost, SP1 and SP2 suffer a corresponding decline in the value of their security and the value of the unsecured residue to the debtor or the debtor's trustee in bankruptcy is correspondingly increased. Suppose, for instance, that the proceeds are only $9,000 instead of $10,000. SP1 then receives 3/10 of $9,000 or $2,700 and SP2 gets 5/10 of $9,000 or $4,500, leaving an unsecured residue of

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[4] See footnote 1

$1,800 for the debtor or the debtor's trustee in bankruptcy. This seems unfair since $800 of the component collateral contributed to that residue.

In Gilmore's view, the solution to the problem lies in excluding from the formula any costs which are not attributable to the component collateral. Under his recommended revised formula, the security interests would then share "according to the ratio which the obligation secured by each security interest...bears to the sum of the obligations secured by all such security interests". Thus, in the above hypothetical, SP1 would get 3/8 of the proceeds while SP2 would get 5/8.

It is this formula that was incorporated into the Saskatchewan PPSA and later into section 39 of the Western Model as set out above.

Proposed Variation to Western Model

While section 39 of the Western Model resolves the precise problem addressed by Gilmore, it raised other ambiguities in different circumstances. This is because Gilmore's solution rested on the assumption that the secured parties with an interest in the component collateral should be paid the amount of their full advances before anything is transferred to the unsecured residue. But this assumption is surely correct only in a case - as in Gilmore's hypothetical above - in which the value of the secured obligation is less than or equal to the value of the component collateral prior to commingling or processing. Suppose instead that the hypothetical is varied as follows so that the amount of the secured obligation in fact exceeds the value of the collateral.

> SP1 takes and perfects a security interest in sugar to secure an advance of $3,000. SP2 takes and perfects a security interest in chocolate to secure an advance of $5,000. The debtor combines the chocolate and the sugar to make candy. The market value of the sugar at this point is $2,000 and that of the chocolate is $4,000. The debtor's labour and overhead amount to $2,000.

Suppose the proceeds realized against the collateral are $8,000. Applying the ratio formulated by Gilmore, SP1 is entitled to 3/8 of the $8,000 or $3,000 and SP2 will be entitled to claim 5/8 of the $8,000 or $5,000. The secured parties, in other words, are entitled to claim a security interest up to the full amount of their advances even though the amount of the secured obligation exceeded the value that the component collateral would have yielded on a realization prior to the commingling. This results in the converse injustice. Now the value of the interests continued in the finished product is increased and the secured parties receive a windfall at the expense of the person entitled to the unsecured residue. Where that person is the debtor, there is no great injustice perhaps since the debtor would be liable personally in any event for the full amount of the secured obligation. But where the residue claimant is the debtor's trustee or a person entitled to the security interest in the whole, there is prejudice. After all, if the secured party had attempted to realize on the security prior to the commingling by the debtor, it would only have received the market value of the component collateral and why should it receive the benefit of any increase in value as a result of the commingling since the increase in value came from sources - labour or additional materials- over which it does not have a security interest. That benefit should instead go whichever third party is entitled to the remainder interest in the finished product.

The Western Model PPSA recognizes the problem of valuation and resolves it as follows. Section 39(2) provides that in applying the priority formula of equal ranking and pro rata sharing between security interests in component collateral, the value of the secured obligation cannot exceed the market value of the goods at the date that the goods became part of the product or mass. Section 39(5) applies the same valuation limit in the case where the priority contest is between a security interest in component collateral and a security interest in the finished product or mass itself.

The only problem with this solution is that is applies only in a case where there is more than one security interest in the collateral or the finished product or both. What about the case where the secured party is competing with an execution creditor of the debtor or the debtor's trustee in bankruptcy. It is in order to accommodate this case that the Canadian Conference on Personal Property Security Law will be asked to modify section 39 of the Western Model by restating the valuation rule as a general one.

Priority Between Security Interests in the Same Component Collateral

The application of section 39(2) is limited to the case where security interests in separate goods were taken and perfected before the goods were commingled. What of the case where security interests were taken in the same goods prior to the commingling? In this respect, section 39(3) provides that for the purposes of applying the residual security rules set out in section 35, perfection of the security interest in the original goods also constitutes perfection of the security interest in the resulting product or mass. The security interests in the commingled goods, in other words, have the same ranking that they had prior to the commingling.

Priority between Security Interests in Component Collateral and Security Interests in the Product or Mass

What if in addition to SP1 and SP2 with security interests only in component collateral there is also an SP3 with a security interest in the finished product? Section 39(3) is again relevant and the security interests in the finished product will accordingly be ranked under section 35 in order of the respective dates of perfection of the security interests in the component goods and in the finished product. Where this would result in priority going to the separate security interests in the components over the finished product, the valuation rule discussed places a limit on the quantum of the priority - *viz*, the value of the component goods prior to commingling. Accordingly, SP3 will be able to claim an interest in any residue regardless of subordination subject of course to any other interests that may have priority by independent operation of other sections of the act.

Purchase Money Superpriority

Standing alone, section 39(2) establishes a rule of equal ranking and pro rata sharing for security interests that are continued into the finished product. But what if one of the continued interests is a purchase money security interest? Section 39(5) is intended to preserve PMSI superpriority in that eventuality not only over other security interests in the component collateral but also over security interests taken directly in the product or mass. However, in the event that the finished product or mass is classifiable as inventory, the PMSI holder must fulfill the same notice requirements for superpriority that would otherwise operate pursuant to section 34.

NOTES

SECTION 40

VOLUNTARY SUBORDINATION

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40 **A secured party may, in a security agreement or otherwise, subordinate its security interest to any other interest and the subordination is effective according to its terms between the parties and may be enforced by a third party if the third party is the person or one of the class of persons for whose benefit the subordination was intended.**

COMMENTARY

General

Section 40 is intended to confirm the common law freedom of a secured party entitled to priority to agree to subordinate its claim in order, for instance, to facilitate a fresh injection of capital into the debtor's enterprise by another creditor of the debtor. There is apt to be frequent recourse to the use of subordination agreements under the PPSA in view of the first in time residual rule of priority found in section 35 coupled with the reversal of the common law rule under which a subsequent mortgagee could interrupt the tacking of later advances to an earlier mortgage by giving notice to the senior mortgagee of its intervening security interest and advance. On the other hand, the superpriority accorded to purchase money security interests, provided they are duly perfected in time, eliminates the need for the financier of new collateral to seek a subordination agreement from an earlier registered secured party holding a general security interest in all the debtor's collateral. Under pre-PPSA law, super priority for purchase money security interests was assured only where they took the form of a conditional sales contract.

Registration

A subordination may be registered under section 45(6) of the Act. However, registration is permissive or facilitative and not mandatory since the only party potentially prejudiced by the subordination is the secured party who has agreed to it.

Enforcement of Subordination Agreement by Third Parties

A subordination may take the form of a direct agreement between the senior and junior secured parties or of a general subordination clause contained in the security agreement between the senior secured party and the debtor empowering the debtor to grant subsequent security interests, in specified circumstances, ranking in priority to the senior secured party's interest[1]. At common law, the junior secured party could not enforce a subordination taking the latter form because Canadian law still does not generally permit a third party to enforce a contractual term intended for its benefit. Section 40 is intended to overcome the common law barrier of privity of contract and expressly provides that a subordination may be enforced by a third party if the third party is a person or one of a class of persons for whose benefit the agreement was intended[2].

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[1] In a priority contest between a senior and a junior secured party, the junior secured party's failure to make timely registration of a purchase money security interest does not preclude it from taking the benefit of a general subordination clause in favour of subsequent pmsi holders contained in the senior secured party's security agreement with the debtor: *Euroclean Can Inc v. Forest Glade Invts Ltd* (1985) 4 PPSAC 271 (Ont CA), leave to appeal to SCC dismissed June 3, 1985.

[2] Earlier versions of the PPSA did not expressly address the issue of whether a subordination agreement set out in the security agreement between the senior secured party and the debtor could be enforced by the third party beneficiary despite the absence of privity. Section 39 of the old Ontario Act, for instance, provided simply that a "secured party may, in the security agreement or otherwise, subordinate his security interest to any other security interest". In *Euroclean Can Inc v. Forest Glade Invts Ltd* (1985) 4 PPSAC 271 (Ont CA), the Ontario Court of Appeal ruled that the wording of section 39 was sufficient to overcome the common law privity obstacle. As Houlden JA pointed out, "if s. 39 means only that a subordination clause is enforceable by a third party who is a party to the agreement which created it, the section is bootless, as it adds nothing to the common law". To eliminate all doubt on the matter, section 40 expressly confirms this intention.

SECTION 41

ASSIGNMENTS OF INTANGIBLES AND CHATTEL PAPER: RIGHTS OF THIRD PARTY ACCOUNT DEBTORS

41(1) In this section "account debtor" means a person who is obligated under an intangible or chattel paper.

41(2) Unless the account debtor on an intangible or chattel paper has made an enforceable agreement not to assert defenses to claims arising out of a contract, the rights of an assignee of the intangible or chattel paper are subject to

(a) the terms of the contract between the account debtor and the assignor and any defense or claim arising from the contract or a closely connected contract, and

(b) any other defense or claim of the account debtor against the assignor that accrues before the account debtor acquires knowledge of the assignment.

41(3) A modification of or substitution for a contract made in good faith and in accordance with reasonable commercial standards and without material adverse effect on the assignee's rights under the contract or the assignor's ability to perform the contract is effective against the assignee unless the account debtor has otherwise agreed.

41(4) Subsection (3) applies

(a) to the extent that an assigned right to payment arising out of the contract has not been earned by performance,

(b) notwithstanding that there has been notice of the assignment to the account debtor.

41(5) Where the contract has been substituted or modified in the manner referred to in subsection (3), the assignee obtains rights that correspond to those that the assignee had under the original contract.

41(6) Nothing in subsections (3) to (5) affects the validity of a term in an assignment agreement that provides that a modification or substitution referred to in that subsection is a breach of contract by the assignor.

41(7) Where collateral which is either an intangible or chattel paper is assigned, the account debtor may make payments under the contract to the assignor

(a) before the account debtor receives a notice that

(i) states that the amount payable or to become payable under the contract has been assigned and payment is to be made to the assignee,

and

(ii) identifies the contract under which the amount payable is to become payable, or

(b) after

(i) the account debtor requests the assignee to furnish proof of the assignment, and

(ii) the assignee fails to furnish proof within 15 days from the date of the request.

41(8) Payment by an account debtor to an assignee pursuant to a notice referred to in subsection 7(a) discharges the obligation of the account debtor to the extent of the payment.

41(9) A term in a contract between a debtor on an account or chattel paper and an assignor that prohibits or restricts assignment of the whole of the account or chattel paper for money due or to become due is binding on the assignor, but only to the extent of making the assignor liable in damages for breach of contract, but is unenforceable against third parties.

COMMENTARY

Terminology

Section 41 comes into play where the collateral takes the form of an obligation owing to the debtor by a third party under an either an intangible or chattel paper. It is therefore necessary to begin with a brief discussion of what is meant by these terms.

"Intangible" is a residual category of personal property under the PPSA: it is defined by exclusion in section 1 to mean "personal property other than goods, chattel paper, a document of title, an instrument, money or security". Its most common manifestation will be an "account" (or "book debt" to use current parlance). Though it is also a sub-category of "intangible", "account" is independently defined in PPSA section 1 to mean "a monetary obligation not evidenced by chattel paper, an instrument or security, whether or not it has been earned by performance".

"Chattel paper" is a term coined by the drafters of the UCC to connote a document that embodies not only an account but also a security interest. It is defined in PPSA section 1 to mean "one or more writings that evidence both a monetary obligation and a security interest in or lease of specific goods and accessions". The classic example of "chattel paper" is the commonplace retail conditional sales contract under which a vendor supplies specific goods on credit but retains title to secure the customer's obligation to pay the purchase price. The written contract clearly meets the two characteristics of chattel paper: it evidences both a monetary obligation - the purchase price - and a security interest - the clause reserving title to the goods as security for payment. But conditional sale contracts are mentioned by way of example only and the notion of chattel paper encompasses any other type of document, for instance a chattel mortgage on specific goods, so long as it satisfies the definitional characteristics. See further the definition of chattel paper in section 1.

Scope and Objective of Section 41

A business's chattel paper, accounts receivable and other intangible rights often count among its most valuable assets, especially if it is in the practice of supplying goods and services on credit terms. As such, these types of collateral are frequently made the subject of an assignment both by way of security and by way of absolute or outright sale.

The PPSA in general and section 41 in particular naturally applies to all security assignments. But it is worth recalling here that save for Part 5, the PPSA including section 41 also applies to absolute assignments of accounts and chattel paper: see the commentary on section 3.

Relative to other forms of collateral, intangibles and chattel paper bring into play a unique factor: a third party, the person who is obligated to the debtor. For the sake of convenience, PPSA section 41(1) uses the term "account debtor" to connote the third party contract obligor, regardless of whether she is obligated under an account *strictu senso*, another form of intangible or chattel paper. Section 41 is intended to deal with the effect of the assignment on the rights of the account debtor under the contract with the assignor/debtor that produced the intangible or chattel paper.

An assignee "takes subject to the equities"

At common law, the doctrine of privity of contract precludes a unilateral assignment of intangible contract obligations. But equity permits an assignee to enforce her rights under the assignment at common law by suing the account debtor in the name of the assignor. But equity also "follows the law" and the policy underlying the privity doctrine therefore requires that the account debtor not be prejudiced by the assignor's unilateral decision to substitute a new obligee under their contract. Thus, the maxim "an assignee "takes subject to the equities" meaning that the assignee stands in the shoes of her assignor and acquires no higher or better rights than the assignor had against the account debtor under the contract between them that produced the obligation as well as under any related contract. So if a seller is in breach of contract to her buyer under a conditional sales contract that has been assigned to another, the buyer/account debtor can set off any damage flowing from that breach in an action by the assignor.

This principle has been codified in the PPSA. Under section 41(2), the rights of an assignee of an intangible or chattel paper are subject to the terms of the contract between the account debtor and the assignor and any defence or claim arising from the contract.

Cut off Clauses and Waiver of Defence Clauses

In order to render their accounts and chattel paper more attractive forms of collateral, conditional sellers and obligees under chattel paper frequently attempt to obtain assignability free and clear of the equities by the use of cut off or waiver of defence clauses; viz., clauses inserted in the original contract between the buyer/account debtor and the seller/assignor authorizing an assignment of the contract on terms that the assignee will not be burdened by any defences or claims arising out of the assigned contract. Under traditional privity of contract doctrine, the assignor as a third party to the contract should not in strict theory be able to take advantage of such clauses. On the other hand, the assignment itself is an aberration from the privity doctrine which has in any event lost much of its vigor in the commercial field in recent years. At all events, cut off clauses are in common use and have received a measure of judicial sanction. In the case of consumer credit sellers and lenders, however, attempts to cut off the defences of consumer buyers and debtors have themselves been cut off by legislative intervention in most Canadian provinces, including New Brunswick[1].

The PPSA recognizes but neither sanctions nor endorses the use of cut off clauses. Under section 41(2), an assignee takes subject to the equities unless the account debtor has made an enforceable agreement not to asset defences or claims arising out of the contract. Thus to be effective, the cut-off clause must be enforceable and whether it is or is not continues to be left to the courts and the legislature to determine.

Notice to the Account Debtor "Freezes the Equities"

Under current law, the rule that an assignee takes subject to the equities applies only with respect to defences and claims that arise out of the contract that produced the obligation that was the subject of the assignment or out of any related contract. With respect to rights of set-off between the same parties that may have arisen in consequence of independent transactions between the parties, the assignee can "freeze the equities" by giving notice of the assignment to the account debtor. Once notice is given, rights of set-off are restricted to those that have accrued as of the date of notice since after that date, the account debtor is aware that claims arising out of any further business dealings with the assignor will not give rise to any potential set-off.

Again, this principle is codified in the PPSA. Under section 41(3), the assignee does not take subject to any other defences or claims that accrue after the account debtor acquires knowledge of the assignment.

Modification of the Contract out of which the Assignment Arose

An assignee of contract rights will naturally be concerned that the account debtor's payment obligation is not diminished or extinguished by a subsequent modification or rescission of the contract between the assignor and the account debtor. Under existing common law and equitable principles, it seems that any subsequent modifications and substitutions of the contract will not be effective against the assignee once the account debtor has notice of the assignment. In the case of a fully executed contract, this is fair enough. Once performance has been rendered, the right to payment has vested, so to speak, and it should then be too late for the parties to amend or rescind their contract without at least procuring the assignee's consent. But while the account debtor's performance remains executory, new or changed circumstances may well require modification of the contract even after notification. Unless the value of the assigned contract rights is substantially impaired by the subsequent change or modification, it seems unduly restrictive to require the assignee's consent simply because the account debtor has had notice of the assignment. Accordingly, to the extent that the assigned right of payment has not yet been earned by performance, section 41(3) permits a post-notification modification or substitution of the contract between the assignor and account debtor provided certain conditions are met. The changes must be made in good faith, in accordance with reasonable commercial standards and without material adverse effect on the assignee's rights under the contract or the assignor's ability to perform the contract. The assignee automatically acquires rights under the modified or substituted contract corresponding to those it had under the original contract.

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[1] *Cost of Credit Disclosure Act*

Account Debtor's Obligation to Pay Assignee upon Notice

An account debtor is naturally not affected by an assignment unless and until she receives notice that the obligation has been assigned and is directed to make payment to the assignee. Until then, she may continue to make payment to the assignor without fear of liability to the assignee. Upon proper notice, however, all further payments must be made directly to the assignee and if the account debtor persists in making payment to the assignor, she can be made to pay twice. This rule is codified and fleshed out by PPSA section 41(7).

NOTES

PART 4
REGISTRATION

SECTION 42

PERSONAL PROPERTY REGISTRY

42(1) **There shall be a registry known as the Personal Property Registry for the purposes of registrations under this Act and for registrations that are permitted or required under any other act to be made in the Registry.**

42(2) **The Minister may designate a person as Registrar.**

42(3) **The Registrar may have a seal of office in the form prescribed.**

42(4) **The Registrar may designate one or more persons as Deputy Registrars.**

42(5) **Notwithstanding any regulation made under section 74, when in the opinion of the Registrar, the circumstances are such that it is not practical to provide one or more registry services, the Registrar may**

(a) **refuse to register financing statements,**

(b) **refuse to accept requests for search results, and**

(c) **otherwise suspend one or more of the functions of the registry,**

for the period of time during which, in the opinion of the registrar, those circumstances prevail.

COMMENTARY

A Single Registry for all Security Interests

The Personal Property Registry to be established under section 42 will fulfill the same function as the current personal property registries. It will enable secured parties to publicize all non-possessory security interests taken in their debtors' personal property so as to allow third parties who later deal with the debtors or the collateral to search for outstanding encumbrances.

Under the current law, registrations and searches must be conducted in four separate registry systems. Which system is the relevant one depends on a bewildering array of factors: the type of security device, the form of the security documentation, the nature of the collateral and the corporate or non-corporate status of the debtor. Mortgages of chattels are registered under the *Bills of Sale Act*, conditional sale and lease/option agreements relating to chattels under the *Conditional Sales Act*, assignments of book debts under the *Assignments of Book Debts Act* and security interests in chattels or book debts or both that are set out in a debenture or trust deed given by a corporate debtor under the *Corporation Securities Registration Act*.

The PPSA discards the conventional formalistic distinctions among security devices, replacing them with the concept of a single generic "security interest"[1]. This evolutionary step makes it possible to have a single central registry for all security interests taken in personal property, regardless of the form of the security agreement or the location of title as between the parties. The Personal Property Registry will accordingly replace the four discrete registry regimes currently in place.

The volume of registrations in the new Registry is expected to substantially increase from the current aggregate levels. There are several reasons for this.

Firstly, the PPSA registration regime will apply to security interests taken in any and all forms of personal property.[2] In contrast, the scope of the existing registration regimes is limited to security interests taken in goods or accounts. Even then, there are significant exceptions. Specific assignments of book debts, for instance, are excused from registration under the *Assignment of Book Debts Act*.[3]

Secondly, the PPSA registration regime will apply not just to security interests *strictu senso* but also to certain non-security dealings in personal property[4]. These include a commercial consignment, a lease of chattels for a term greater than one year and an absolute assignment of accounts or chattel paper. Commercial consignments are not subject to any equivalent registration regime at present. True leases are not required to be registered under the *Conditional Sales Act* or elsewhere at present unless the hiring agreement contains an option to purchase. And while both absolute and security transfers of accounts are now required to be registered, the existing regimes do not cover chattel paper which in fact is a new and novel category of personalty under the PPSA[5].

Integrating the Personal Property Registry with Non-PPSA Personal Property Interests

The PPSA itself applies only to *consensual* security interests in personal property. Liens, charges and other interests that arise by operation of law rather than agreement between the parties are excluded from the scope of application of the Act[6] as indeed they are from the existing registry systems.

However, in PPSA jurisdictions elsewhere in Canada, the Personal Property Registry has evolved to become the registration venue for a wide variety of non-consensual encumbrances against personal property.

In Alberta, for instance, the following non-PPSA interests can be registered in the Personal Property Registry:

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[1] See the commentary on PPSA section 2.
[2] See the commentary on section 2.
[3] *ABDA*, section 2.
[4] See the commentary on section 4.
[5] See the commentary on the definition of "chattel paper" in section 1.
[6] See the commentary on section 4(a).

Buyers may register their interest in goods left in the possession of their seller so as to avoid possible subordination of their interest to a subsequent transferee from the seller under the Alberta *Sale of Goods Act* or *Factors Act*.

The Alberta *Garageman's Lien Act* allows garage keepers to register their liens on an owner's vehicle for repairs, parts or storage for which they have not been paid so as to preserve the priority of their liens against third parties notwithstanding that possession of the vehicle has been relinquished to the owner[7].

A spouse who has been awarded exclusive possession by a Court of a mobile home or household goods under the Alberta *Matrimonial Property Act* may register the Matrimonial Property Order so as to avoid possible subordination of the interest to third parties.

A creditor's interest under a writ of execution issued by the Alberta Court of Queen's Bench or the Federal Court of Canada may be registered under the Alberta *Seizures Act* so as to avoid subordination to third party interests which may subsequently attach to the judgment debtor's assets[8].

Finally, a Workers' Compensation Board charge for unpaid premiums against the employer's assets under the *Workers' Compensation Act* and a mortgage deed under section 63 of the *Railway Act* can be registered in the Personal Property Registry[9].

The role of the Personal Property Registry in relation to these non-PPSA interests is not regulated by the PPSA itself but by the statute that regulates the particular lien, charge or other interest. The Personal Property Registry has merely been adopted as the logical and convenient "one stop shopping" venue for registering and searching all forms of encumbrances affecting personalty.

In New Brunswick, the Personal Property Registry will likewise be adopted as the registration venue for a wide array of non-PPSA liens, charges or other interests under amending legislation introduced contemporaneously with the enactment of the PPSA[10]. This will also contribute to the anticipated increase in the volume of registrations in the new registry.

A Computerized Registry

The new Personal Property Registry could be operated, as the present registries are, on a manual basis. But a manual registration system would make no sense in an era when the benefits of computerized information storage have been amply demonstrated. Not surprisingly, all of the new registries that have been established in PPSA jurisdictions to date are computer-based. Information submitted for registration is stored in a computer database against which searches are conducted. Indeed, in most of these jurisdictions, the pre-PPSA registries had already been at least partially automated.

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[7] A non-possessory repairer's lien is *not* recommended for implementation in New Brunswick at this time: see the commentary on section 32.

[8] For a discussion of the interrelationship between registering writs of execution in the Personal Property Registry and the PPSA, see the commentary on section 20.

[9] See further the commentary on section 4(a).

[10] See the commentary on sections 4, 20 and 32.

But while computerization is universal, there are differences in system design among PPSA jurisdictions. This is due is part to differences in design taste among jurisdictions and in greater part to differences in the state of the available technology depending on when the system was introduced. Saskatchewan's system, for instance, is now over a decade old. Ontario's is even older although there have been ongoing refinements. The Alberta and British Columbia systems are the most modern, having been implemented only in the fall of 1990. New Brunswick Geographic Information Corporation, the body responsible for developing, implementing and administering the New Brunswick Personal Property Registry, will benefit greatly from the accumulated experience elsewhere.[11]

A Province-Wide Registry

With the exception of the *Corporation Securities Registration Act* registry located in Saint John, the existing personal property registry systems are all based in the county land registry offices. Re-registration must be effected every time the secured party discovers that the collateral or debtor or both have moved from one part of the province to another and credit searchers can rely on a search result only for the immediate area.

At a more parochial stage in New Brunswick's history, it was no doubt convenient to be able to use the land registry premises and personnel to provide a venue and to administer the registrations and searches for personal property security. But in an era of high social mobility of people and their personalty, a county-based registry system greatly undermines the publicity function of the system. Moreover, the advent of computerization makes a centralized province-wide data base a relatively straightforward proposition. Accordingly, the Personal Property Registry will introduce to New Brunswick for the first time a universal registry system covering all security interests taken in personal property on a province-wide basis. Indeed, with Maritime and Atlantic economic union in the wind today, a regional Personal Property Registry is an idea that should be kept in mind from the outset in the development of the New Brunswick system.

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[11] The prospects for eventual harmonization of registry systems among PPSA jurisdictions were greatly enhanced by the establishment of a Registry Committee with precisely that mandate at the June 1991 meeting of the Canadian Conference on Personal Property Security Law. Rod MacKenzie, Vice-President (Legal) of the New Brunswick Geographic Information Corporation, is a member of that Committee.

SECTION 43

REGISTRATION OF FINANCING STATEMENTS

43(1) A person who wishes to have a financing statement registered shall submit it for registration at an office of the registry.

43(2) Registration of a financing statement is effective from the time assigned to it in the office of the registry and, where 2 or more financing statements are assigned the same time, the order of registration is determined by reference to the registration numbers placed on the financing statement in the registry office.

43(3) The registrar shall not register a financing statement or issue a search result under this Part until any prescribed fees have been paid or arrangements satisfactory to the registrar for their payment have been made.

43(4) A financing statement may be registered before a security agreement is made and before a security interest attaches.

43(5) A registration may relate to one or more than one security agreement.

43(6) The validity of the registration of a financing statement is not affected by a defect, irregularity, omission or error in the financing statement or in the registration of it unless the defect, irregularity, omission or error is seriously misleading.

43(7) Subject to subsection (9),

(a) where one or more debtors are required to be disclosed in a financing statement, or

(b) collateral is consumer goods that are of a kind prescribed by the regulations as serial numbered goods

and there is a seriously misleading defect, irregularity, omission or error in

(c) the disclosure of the name of any of the debtors other than a debtor who does not own or have rights in the collateral or,

(d) the serial number of the collateral,

the registration is invalid.

43(8) Where it is alleged that a defect, irregularity, omission or error is seriously misleading, it is not necessary to prove that anyone was actually misled by it.

43(9) Failure to provide a description in a financing statement in relation to any item or kind of collateral does not affect the validity of the registration with respect to other collateral contained in the financing statement.

43(10) **Notwithstanding anything in this Part, the registrar may reject a financing statement when, in the opinion of the registrar, it does not comply with this Act or the regulations or any other Act or regulation under which registration of a financing statement is authorized.**

43(11) **The registrar shall give the reason for the rejection of a financing statement under subsection (10).**

43(12) **The secured party or person named as secured party in a financing statement shall give to each person named as debtor in the statement, not later than 30 days after it is registered or issued, as the case may be,**

(a) **a copy of the statement reproduced on paper, or**

(b) **a copy of a verification statement issued by the registry relating to the financing statement**

but a copy need not be given to a person who has waived in writing the right to receive it.

COMMENTARY

Notice Filing

The existing registries are all document-filing systems. That is to say, secured parties must file a copy of the actual written security agreement, in some cases accompanied by supplementary affidavits and subject to detailed content requirements.

The PPSA will replace document-filing with a notice-filing system under which secured parties are required to file only a simple notice document called a "financing statement". The financing statement sets out only the bare information necessary to alert a searcher that a security interest may exist against certain collateral, *i.e.*, the name and address of the secured party, the name and address of the debtor and a description of the collateral. Any changes or amendments may be effected by filing an equally brief financing change statement.

The adoption of a notice-filing system will better ensure the confidentiality of the debtor's credit arrangements. Under the current registry systems, the financial details of the security arrangement are a matter of public record accessible by anyone who wishes to search. Under the PPSA notice-filing model, the security agreement itself will remain between the parties. Only those categories of third parties who have a legitimate interest in knowing will be entitled to demand detailed particulars from the secured party of record[1]. Notice filing will also significantly reduce the administrative burden on the registry and its personnel by dramatically reducing the volume of paper required to be processed for each registration. This, in turn, will offset the administrative burden caused by the anticipated increase in the aggregate number of registrations[2].

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[1] See the commentary on section 18.

[2] See the commentary on section 42.

Pre-Agreement Registration

Since the security documentation itself must be filed, registration cannot be effected in the current registry systems until after the parties have executed their agreement. To enable secured parties to release funds to the debtor immediately on execution of the security agreement, the existing Acts purport to allow a thirty day "grace period" to effect registration. However, the existence of grace periods significantly undermines the reliability of the registry as an accurate source of current information to potential third party transferees of the collateral. Accordingly, the existing statutes, with the exception of the *Conditional Sales Act*, also provide that a security agreement is not enforceable against creditors or subsequent mortgagees and purchasers of the collateral unless and until the agreement is registered. Thus, the thirty day grace period under these acts offers only illusory protection to secured parties against intervening interests and a cautious lender will not release loan funds upon execution of the agreement pending its registration. Even though the *Conditional Sales Act* continues to provide a true grace period for registration of conditional sales of chattels, the temporary protection this offers is considerably diluted by provisions in the *Sale of Goods Act* and the *Factors and Agents Act* protecting intervening purchasers and pledgees of the collateral[3].

The adoption of a notice filing system eliminates any practical obstacle to pre-agreement registration. Section 43(4) accordingly makes it clear that a financing statement may be registered before a security agreement is entered into and before the security interest attaches. Of course, the registering party will still have to fulfill the necessary prerequisites to gaining an effective security interest in the collateral including obtaining the debtor's agreement. However, once the security interest attaches, the secured party's priority will relate back to the date of registration under the general or residual PPSA priority rule[4].

The ability to pre-register will enable secured parties to secure their priority ranking during the negotiation period, allowing immediate release of the loan funds to the debtor upon execution of the actual security agreement and largely eliminating the need to provide grace periods for registration with their attendant complexities. These advantages will in turn encourage the highest possible use of the Personal Property Registry.

Admittedly, pre-agreement registration creates the risk of "false" registrations should the negotiations fall apart after registration is effected or in the rare case of a crank or indeed malicious registration. Does this risk not compromise the debtor's credit worthiness and the integrity of the registry system as a whole? In fact, the experience in PPSA jurisdictions to date does not support any real cause for worry.

In the first place, the existence of a misleading record entry in a notice-filing system that permits advance registration has a far less prejudicial impact on the debtor's credit reputation than in a documentary filing system. The right to effect advance registration means that registration only constitutes notice of the *potential* existence of a security interest in the described collateral to secure an unknown amount of debt. Whether a security interest has in fact been taken and in what amount is only ascertainable by contacting the secured party directly.

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[3] The *sui generis* treatment of conditional sales in this respect is based on sound policy. For this reason, the PPSA also gives a grace period for registration of conditional sales and other purchase money security interests with protection afforded to intervening purchasers and lessees: see the commentary on section 20.

[4] See the commentary on section 35.

Copy to Debtor

Moreover, the PPSA itself provides an important hedge against potential abuse of the pre-agreement registration privilege. Section 43(12) obligates the secured party to give a copy of the financing statement (or a verification statement in the event the registration data is entered directly by a remote user) to the debtor within 30 days after it is registered (or issued). The sole exception is where the debtor has executed a written waiver of its right to notice since a written waiver functions as advance notice of the registration. On receipt, the debtor can force a discharge or amendment of the registration to the extent it turns out to be false or misleading[5].

An even better solution would of course be to place the onus on the Registrar rather than the secured party to notify the debtor of the particulars of a registration against her or his name. The cost-efficiency of this alternative is presently being explored in Saskatchewan and should be considered for New Brunswick as well. It it turns out to be feasible, section 43(12) will be deleted.

It is worth noting that the new Ontario PPSA also allows pre-agreement registration, subject to one important exception. Where the collateral includes "consumer goods", a financing statement cannot be registered unless and until the security agreement has been signed by the debtor[6]. The Ontario exception is not found in the Western Model and it is not recommended for incorporation in the proposed New Brunswick PPSA either. For the reasons just stated, it is thought that the risk of false or misleading registrations has been sufficiently countered. Absent evidence of significant secured party abuse of the system in the consumer context, there is no reason to take extra measures.

A Single Registration for Multiple Security Agreements

Under the existing documentary filing systems, any modification or replacement of the original security agreement may require a fresh registration. But under the PPSA notice-filing system, the registry will no longer function as a depository of all the detailed terms of the financing arrangement. The secured party is obligated to register only the bare particulars of the transaction: essentially, the names of the parties and a description of the collateral covered by the security interest. Under such a system, there is no reason why registration of one financing statement may not operate to perfect a security interest arising under more than one security agreement so long as the registered particulars continue to accurately reflect the cumulative or modified financing arrangements between the parties. Accordingly, section 43(5) provides that a single registration may relate to more than one security agreement.

In combination with pre-agreement registration, the ability to relate one registration to multiple or successive security agreements offers tremendous flexibility. The parties are able to modify their financing arrangement as circumstances dictate without having to worry about also modifying the registered documentation. The secured party who is negotiating a financing arrangement with a debtor can register one financing statement describing any collateral that may conceivably be covered. Even if the initial security agreement that is actually executed covers a less extensive range of collateral, any security interest that is taken in a more extensive refinancing down the line will still relate back to the date of initial registration for priority purposes[7].

But do the priority advantages enjoyed by the first-registering secured party in relation to all collateral described in the financing statement impose any hardship on either the debtor or third parties? In answering that question, one must be careful to distinguish the financing statement that is registered from the security agreement that is actually executed. Registration of a financing statement covering all the debtor's present and future personal property does not of itself give the secured party a first priority in all assets. Unless a security agreement to this effect is actually executed, the secured party does not even have a perfected security interest in the debtor's assets either against the debtor or against third parties. To ascertain the extent of the secured party's security interest, reference must be made to the terms of any security agreements actually in existence. Of course, subsequent secured parties who wish to take security in collateral not yet covered by an existing security agreement but which is the subject of a prior registration cannot be assured that one might not be negotiated down the line giving the first registering party priority at that stage, notwithstanding that the agreement came later in time. This risk can, however, be dealt with by the subsequent creditor either negotiating a subordination agreement with the first-registering party or simply paying out the first interest and ensuring that the registration is discharged. The new rule allowing single registrations for multiple security agreements does not, in other words, create any kind of first lender monopoly that is not already contemplated by the secured lending system.

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[5] See further section 50.

[6] Ontario PPSA section 45(2)

[7] See the commentary on section 35.

Indeed, the new rule may well encourage secured parties to take less collateral as security than they do now. Under the existing document-filing systems, a secured party may be tempted to require the debtor to grant a security interest in more collateral than is really necessary to support the initial loan arrangement in order to ensure that it retains any priority advantages that may flow from its first in time registration. Under a notice-filing system, on the other hand, the initial security agreement can be tailor made to meet immediate needs since any subsequent financing arrangement that expands the scope of the collateral covered will relate back to the initial registration (so long as it covered the added collateral) for priority purposes. There is, in other words, no longer the same pressure to cover more collateral at any given time than is strictly necessary to support the amount of loan monies actually at risk in the current financing arrangement.

Finally, the debtor can force the secured party to amend the registration to the extent it covers collateral which is not if fact subject to a current security interest.[8].

The new Ontario PPSA provides that a single registration may cover multiple security agreements except where the collateral is consumer goods[9]. Again, this exception is not found in the Western Model and it is not recommended for incorporation in the proposed New Brunswick PPSA either. The experience in other PPSA jurisdictions does not suggest that there is any need for special consumer protection here so as to justify the inconvenience and inefficiency of requiring multiple registrations. Indeed, the Ontario exception is likely to produce an unnecessary multiplicity of successive registrations by secured parties fearful that every modification made to the initial security agreement may be challenged later in time as a new agreement requiring a fresh registration.

Effect of Errors and Omissions in Registration Particulars

As is the case presently, it will be the registrant's responsibility to ensure that the information submitted for registration in the new Personal Property Registry is accurate and complete. However, the test for determining whether and when an error or omission will invalidate the registration under the PPSA differs from those found in the existing registration statutes.

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[8] See further section 50.

[9] Ontario PPSA section 45(4).

Among the existing registration statutes, the *Conditional Sales Act* is the only one to limit remediable error to clerical mistakes. The other acts do not limit the class of defects subject to cure. Instead, the test for invalidity is whether the defect, however serious, has actually prejudiced a searcher. Under these Acts, a "defect, irregularity, omission or error" does not invalidate a registration so long as it has not "actually misled any person whose interests are affected by the document"[10].

The PPSA approach is fundamentally different from either of the existing models. Unlike the *Conditional Sales Act*, section 43(6) does not limit remediable error to mere technical defects. But unlike the other three existing acts, the test for invalidity is not whether the defect, etc. "actually misled" anyone but whether the defect is "seriously misleading" from the viewpoint of an abstract reasonable searcher. The approach, in other words, is intended to be objective rather than subjective and section 43(8) makes it abundantly clear that a registration will be invalidated for a seriously misleading error even though it cannot be shown that any concrete third parties actually relied to their detriment on the misleading information contained in the registry.

The problem with employing a subjective test to determine curable error is that it fails to take account of the dual function of the registration requirement. Registration no doubt functions to ensure publicity of the existence of the security interest to subsequent transferees of the collateral (e.g., purchasers and other secured parties) who might otherwise be misled by the debtor's apparent ownership of assets in its possession. If this were the sole reason for requiring registration, it would indeed be unfair to penalize the secured party for a recording error that had not actually prejudiced anybody.

But in North American commercial and insolvency law, registration has long performed the important second function of determining rights between secured and unsecured creditors. Under both the existing law and the PPSA, an unregistered non-possessory security interest in collateral is subordinated to the rights of the debtor's unsecured creditors and their representatives including a trustee in bankruptcy. Failure to register effectively reduces the secured creditor to the same status as its unsecured counterparts and this will be the case regardless of whether their debts arose prior or subsequent to the unregistered interest[11]. It follows that as regards unsecured creditors the registration requirement is not intended to protect against detrimental reliance (except perhaps to the extent that judgment creditors may rely on a registry search result in deciding whether to initiate execution against the debtor's assets). Instead, the primary reason is to provide an economically efficient means of demarcating the point at which secured creditors can assert the privilege of that status as against the debtor's ordinary creditors. The threat of subordination also serves to encourage registration, thereby promoting the integrity of the system.

Section 43(7) specifically addresses the effect of registration errors or omissions in relation to the two principal search criteria under the PPSA - the debtor's name and the serial number of collateral that is defined by the regulations as serial numbered goods. The search criteria are regarded as so essential to the integrity and searchability of the registry system[12] that a seriously misleading registration defect in relation to either item will invalidate the registration, even if the other is correct. The intended effect of section 43(7) is thus to preclude a secured party from arguing: (1) that a seriously misleading defect in the debtor's registered name is not fatal if the serial number is correctly stated since a search by serial number would have disclosed the registration; or (2) in a case where there are multiple debtors, that a seriously misleading defect in the name of one debtor is not fatal if the other debt-

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[10] *Bills of Sale Act*, s 27; *Assignment of Book Debts Act*, s 17; *Corporation Securities Registration Act*, s 8.

[11] See the commentary on section 20.

[12] See further the commentary on section 48.

or's name is correct[13].

Finally, section 43(9) specifically addresses the effect of a partial error in collateral description. Whether the seriously misleading defect relates to the serial number or otherwise, the effect of a partial error is to invalidate the registration only with respect to the erroneously-described collateral. The validity of the registration in relation to other collateral that was properly described in the financing statement is not affected. In taking this approach, section 43(7) codifies the doctrine of separability adopted by the courts in ruling on the effect of partial errors under the existing registration statutes[14].

The Financing Statement

All PPSA jurisdictions use the term "financing statement" to describe the basic notice document prescribed for initial registration of a security interest under the PPSA. The form of the statement differs somewhat from one jurisdiction to another owing to differences in taste and in system design. However, all financing statements seek to capture much the same basic information: the proper legal name of the debtor and the debtor's address; a description of the collateral including, where required or permitted by the regulations, the serial number of the collateral; the selected registration life of the registration; and the secured party's name and address.

PPSA section 1 defines "financing statement" to include both a printed document in the prescribed form and, where the context permits, "data authorized under the regulations to be transmitted to the office of the Registry to effect a registration". The definition has been thus extended in order to take account of remote entry registration under which clients may themselves enter the relevant registration data directly into the registry data base using their own computers. At present, electronic remote entry registration is available only in British Columbia but both Alberta and Ontario are contemplating incorporating this feature into their systems.

The forms and uses of the financing statements to be prescribed for use in the New Brunswick Personal Property Registry have not yet been established pending final decisions on registry system design and on what non-PPSA interests in personal property will be subject to registration in the new Registry. However, the following description of the situation in other PPSA jurisdictions should give sufficient flavour of what New Brunswick clientele can expect.

A financing statement is typically a simple one-page document. Should there be insufficient space, schedules in prescribed form may be used to register additional secured party or debtor information or additional collateral information.

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[13] Neither the Saskatchewan nor the Ontario PPSA's contain any equivalent to section 43(7) and judicial reaction to the problem has been mixed. In *Bellini Manufacturing & Importing Ltd.* (1981) 32 OR (2d) 684 (CA), Goodman JA held that an error in the debtor's name was fatal notwithstanding that the serial number of the goods had been accurately recorded. But *Bellini* was a case where the registration of the serial number was not mandatory. In a case where both were required, the Saskatchewan Court of Appeal ruled that an error in debtor name was not seriously misleading if the security interest would have been disclosed by a serial number search: *Ford Credit of Canada Limited v. Percival Mercury Sales Ltd.* [1986] 6 WWR 569. Section 43(7) is intended to forestall the argument from succeeding again. For the reasons why, see Ronald Cuming "Judicial Treatment of the Saskatchewan Personal Property Security Act" (1987) 51 Sask L Rev 129, at 140-144.

[14] *Hunt v. Long* (1916) 27 DLR 337 (Ont CA)

In addition to its most frequent use to register a security agreement under the PPSA, a financing statement in PPSA jurisdictions is typically used to also register: (1) security interests arising under pre-PPSA security agreements which were not previously subject to registration; and (2) non-PPSA liens, charges and other interests in personal property which under their governing legislation are directed to be registered in the Personal Property Registry. A separate Financing Statement (Transition) may be prescribed for re-registering pre-PPSA security interests that were registered in one of the pre-PPSA registries replaced by the Personal Property Registry[15].

All PPSA jurisdictions have developed comprehensive Registration and Search Guides which provide detailed direction on completing the registration forms. The New Brunswick Geographic Information Corporation intends to develop similar materials for the assistance of Registry clientele in this Province.

Registration Methods and Venue

In Alberta, British Columbia and Saskatchewan, all registrations of printed financing statements or financing change statements are processed at a central Personal Property Registry office located in the provincial capital. Registrations may be tendered to the office in person or by mail or facsimile. In Alberta, registrations may also be tendered to a branch office located in Calgary.

In Ontario, registration may be effected in person at any one of the 49 branch registry offices or by mail to the Central Registration Branch ("CRB") located in Toronto. All registrations are processed at the CRB in Toronto with branch registrations couriered to Toronto overnight.

In British Columbia, BC OnLine, an information service operated by the Province of British Columbia provides remote electronic access to the Personal Property Registry as well as the Land Titles Registry and the Companies Registry. Clients who wish remote data entry access must register with BC OnLine and open a minimum deposit account which is applied to their future use of BC OnLine. In order to use BC OnLine, registrants must have an IBM-compatible personal computer, a modem meeting specified common standards and the requisite communication software. BC OnLine provides a User's Guide to its clients as well as a manual for each database and a tutorial diskette. Clients may also deliver a completed financing statement in person to a local government agent who will electronically enter the registration data on the client's behalf through the BC OnLine system.

It is recommended that New Brunswick minimally offer the following registration methods at the outset: (1) in person delivery at a central registry office or at any district land registry office; and (2) mail or courier or facsimile delivery to the central registry office. The district registry offices should be equipped with the equivalent of the BC OnLine remote entry service so as to permit registry personnel located in these offices to immediately input the registration data into the central registration data bank rather than requiring physical transmission of the actual financing statement to the Central Registry before registration can occur. In time, the remote entry system should be made available to Registry clientele to use on their own premises.

In most PPSA systems, registration fees may be paid either on the spot or by an authorized deduction from an approved deposit account set up between the secured party and the registry office. However, Alberta extends credit to and periodically bills regular clientele. This policy has apparently proved to be far more administratively efficient than the deposit account system and it is therefore recommended for adoption by Geographic Information Corporation in New Brunswick.

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[15] On transitional registration, see the commentary on section 73.

Effective Date and Time of Registration

The effective date and time of registration is critical under the PPSA because of the integral relationship that exists between priority and registration. Under the general or residual PPSA priority rule, all security interests that were perfected by registration are ranked in order of registration[16].

All versions of the PPSA provide that registration of a financing statement is effective from the date and time assigned to it in the office of the registry. But *when* the date and time is assigned differs between Alberta and other PPSA jurisdictions.

In British Columbia, Saskatchewan and Ontario, the date and time of receipt of the statement in the office is recorded as the date and time of registration. Statements tendered by mail that arrive on the same day are assigned the same date and time. Statements tendered in person are assigned their actual date and time of receipt in the office. In the case of both mail and over the counter registrations, a registration number is assigned once the information is processed by the registry personnel and accepted into the computer record. Under the British Columbia remote registration system, electronically transmitted registrations are assigned a date, time and registration number as soon as the information passes through all the system edits and is accepted into the system.

Registration information is naturally not available for searching until it is actually entered into the data base and verified by the system. While electronically submitted registrations are searchable immediately they are entered into the system, there is a time lag of anywhere from 24 to 48 hours between receipt in the office and entry in the system in the case of manual registrations. For this reason, search results display a currency date which indicates the date to which all registrations have been processed and are searchable.

In Alberta, however, searches can be conducted on "real time". The financing statement is examined by the Registry personnel on receipt for completeness and formal acceptability under the regulations. If the information is complete and acceptable, the relevant data is then entered into the data base. It is only after the information recorded from the statements has passed through all system edits that a registration date, time and number is electronically assigned by the system.

The advantage of the Alberta approach is that search results are current. In the other jurisdictions where there is a time lag between registration and searchability, registrants have to wait until their registration shows up on a search before they can safely release funds. The only disadvantage to the Alberta approach is that registrants must submit their registrations in enough time to ensure that the data is actually entered and registered before the expiry of any applicable time limits for registration under the PPSA. The experience in Alberta to date suggests that this disadvantage does not outweigh the advantages and the Alberta approach is therefore the one recommended for New Brunswick.

In the event that two financing statements covering the same collateral and the same debtor are assigned the same date and time, all PPSA's provide that the registration number is then used to determine priority. As a practical matter, the need to resort to this method of resolving priority is apt to arise rarely.

Verification Statements

In all PPSA registry systems, a verification statement is automatically produced on the entry of the data from a financing statement or financing change statement in the Personal

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[16] See the commentary on section 35.

Property Registry data base. The Registry then forwards the verification statement by mail to the secured party of record and the registrant (if different). The verification statement displays the registration number assigned to it by the Registry, the date and time of registration, the particulars of the registration exactly as they were entered into the data base and as they will appear on a search result, and any other registrations in the same registration family.

The verification statement incorporates a detachable financing change verification statement which can be used to register a discharge or renewal of the registration to which it relates. In Alberta and Saskatchewan, the statement can also be used to notify the registry of any error made in the initial registration. The Registry then follows up by registering a financing change statement correcting the error. In British Columbia, the correction of any error by either the registering party or the registry must be made by registering a completed financing change statement displaying the relevant change. In Saskatchewan, the detachable portion may also be used to register an amendment of a previous registration. In all the other jurisdictions this is accomplished by a financing change statement. In New Brunswick, it is recommended that the use of the detachable financing change verification statement be limited to recording a discharge or a renewal. To avoid confusion and to ensure accuracy in the correction of errors, all other amendments should be accomplished by the use of a financing change statement as in the British Columbia system.

SECTION 44

DURATION, RENEWAL OF AND AMENDMENTS TO REGISTRATIONS

44(1) **Except as otherwise prescribed, a registration under this Act is effective for the period of time indicated on the financing statement by which the registration is effected.**

44(2) **A registration may be renewed by registering a financing change statement at any time before the registration expires and, except as otherwise prescribed, the period of time for which the registration is effective shall be extended by the renewal period indicated on the financing change statement.**

44(3) **An amendment to a registration may be effected by registering a financing change statement at any time during the period that the registration is effective and the amendment is effective from the date the financing change statement is registered to the expiry of the registration being amended.**

44(4) **When an amendment of a registration is not otherwise provided for in this Part, a financing change statement may be registered to amend the registration.**

COMMENTARY

Variable Registration Periods

Under the existing registration acts, registration remains effective for only three years. A renewal must be filed to maintain the registration life of the security instrument. The only exception is the *Corporation Securities Registration Act*. In order to accommodate the medium to long term nature of most corporate debt financing, documents remain registered in the *CSRA* registry until positively discharged.

The PPSA will introduce the flexibility of variable registration life for all types of security interests. The regulations under the Act will permit a secured party to select a registration life of from one to twenty-five (whole) years or perpetuity. Registration fees will be based on a sliding tariff, increasing with an increase in the registration life selected[1].

The new Ontario PPSA imposes one qualification on the secured party's right to choose perpetual or variable registration. Where the collateral is "consumer goods", the financing statement is deemed to have a registration life of five years unless a shorter period is specified on the statement[2]. Any renewal is likewise deemed to be for five years unless a shorter period is specified on the financing change statement[3].

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[1] Under the Ontario PPSA tariff, for instance, the fee is $5 per year to a maximum of $125 (for 25 years) and $500 for a perpetual registration. Under the British Columbia tariff, the fee is $5 per year of registration (plus a $3 surcharge per registration unless the client searches directly via BC OnLine) while the infinity registration life option costs $400 (plus

The Ontario exception is presumably intended to protect consumer debtors against a secured party's neglect to register a discharge after the debt is long liquidated. But the exception diminishes the availability of variable registration. Since it applies in every case where the collateral *includes* consumer goods, the registration life of a general security interest taken in both business and consumer assets is limited to five years unless a separate financing statement and a separate security agreement is registered and executed for the consumer goods.

The Ontario consumer goods exception is not found in the Western Model and it has not been recommended for adoption in New Brunswick either. It is thought that a sufficient measure of consumer protection is offered by section 50 which obliges secured parties, where a registered financing statement relates exclusively to consumer goods, to register a discharge within 30 days after all obligations under the security agreement have been performed. Moreover, the experience in Saskatchewan, where variable registration has been available for more than a decade, indicates that the most effective means of encouraging timely discharge lies in simplifying the discharge procedure and not charging any fee for it.

In any event, failure to discharge a registration in a PPSA notice-filing system does not have as prejudicial an impact on a debtor's credit reputation as it does in a document-filing system. Under the PPSA system, credit searchers can find out about the current status of a registered financing arrangement only from the parties themselves[4]. Registration by itself does not say anything more about a person's state of solvency than that a security interest *may* have been taken in the indicated collateral to secure an unknown amount of debt.

Amending a Registration: How and Why

Under section 44(3), a secured party may amend a registration by filing a financing change statement at any time prior to its expiry. The amendment will be effective from the time it is filed until the expiry of the registration to which it relates.

A registrant may wish to amend a registration for a wide variety of reasons. These include to correct an error or omission discovered in a previous registration or to record a court order or a change in the secured party's name or address. Other possible amendments are the subject of separate provision elsewhere in Part 4. See:

section 45	full or partial transfer of security interest by secured party; subordination of security interest to the interest of another person
section 50	discharge of registration; full or partial release of collateral; amendment of collateral description to exclude assets that are not collateral under the security agreement
section 51	transfer of debtor's interest in collateral or change of debtor's name

Failure to register some types of amendments may cause a loss of perfected status or

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(continued)
the $3 surcharge as above).

[2] Section 55(5)

[3] Section 51(6)

[4] See the commentary on section 18.

subordination to subsequent interests in the collateral. This is generally the case where changes in the status of the collateral or the debtor subsequent to a previous registration undermine the continued searchability of the security interest[5]. In other cases, searchability is not affected by the change of circumstances and registration of an amendment is merely facilitative or permissive[6].

Renewals

The availability of variable registration periods will significantly reduce the incidence of lapse. Nonetheless, subsequent events may change what seemed, at the time of filing, to be a most generous estimate of the financing life of a transaction. In that event, the secured party will have to renew its registration in order to maintain its perfected status. Under section 44(2), a registration may be renewed any number of times so long as the renewal is registered before the previous registration expires. Renewal extends the registration life of the financing statement for the time period indicated by the secured party on the financing change statement by which the renewal is effected.

A renewal must be effected by registration of a financing change statement. Registration of a fresh financing statement, rather than a financing change statement, will not be effective to maintain continuity of perfection even though it is registered prior to the expiry of the original registration and relates to the same debtor and the same collateral[7].

To avoid all risk of lapse, a secured party could, in theory, always choose perpetual registration. But the registration fee makes perpetual registration economically impractical for most short to medium term relatively small dollar financing transactions.

Priority Consequences of a Lapsed Registration[8]

If registration lapses, the security interest will still be valid and enforceable against the debtor[9]. But as against third parties, the security interest will lose its perfected status, thereby risking subordination to transferees of the collateral and the debtor's execution creditors or trustee in bankruptcy under section 20 and to other perfected security interests in the same collateral under section 35.

The new Ontario PPSA provides that if registration lapses, the security interest may be perfected again by the registration of a fresh financing statement[10]. A similar provision was not included in the Western Model PPSA. It was thought to be unnecessary and potentially misleading. It is unnecessary because a secured party is entitled to register a fresh financing statement at any time, regardless of whether or not it happens to have registered previously. And it is misleading insofar as it may be taken to imply that a secured party who reregisters a financing statement is in any better position than a secured party who registers a financing statement for the first time. For in general, it is no better to have perfected and lost than never to have perfected at all. Once registration lapses, a re-registration of the financing statement is treated as a new registration. Accordingly, the perfected status and the priority of the security interest to which it relates will date from the time of reregistration without any relation back to the original registration[11]. The only exception is where reregistration takes place within 30 days after lapse or after an erroneous or unauthorized discharge[12]. Even then, the secured party will be vulnerable to interests in the collateral acquired in the interval between lapse and reregistration.

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[5] See, for instance, section 51 regarding the need to register an amendment to disclose a known transfer by the debtor of its interest in the collateral or a known change in the debtor's name subsequent to registration.

[6] See, for instance, section 45 regarding registering a financing change statement to disclose a transfer or assignment by the secured party of its security interest or a subordination agreement.

[7] *Black Hills Credit Union v. CIBC* (1988) 8 PPSAC 199 (Sask CA), *Saskatchewan Credit Union v. Bank of Nova Scotia* (1985) 5 PPSAC 123 (Sask QB), *Moose Jaw v. Pulsar Ventures* (1985) 5 PPSAC 133 (Sask QB)

[8] For a more detailed discussion, see the commentary on section 35(7).

[9] *Canadian Imperial Bank of Commerce v Klunkovski* (1983) 3 PPSAC 216; *Fotti v 777 Management Incorporated* (1981) 2 PPSAC 32.

[10] Section 52(2)

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[11] See, for instance, *Royal Bank v. Demyen* (1986) 6 PPSAC 240 (Sask QB) where a secured party whose registration had lapsed was subordinated to the debtor's trustee in bankruptcy where the secured party did not re-register until nearly one month after the debtor had filed an assignment in bankruptcy.

[12] See further the commentary on section 35(7).

SECTION 45

REGISTRATION OF TRANSFERS AND SUBORDINATIONS

45(1) **Where a secured party with a registered security interest transfers the security interest or a part of it, a financing change statement may be registered disclosing the transfer.**

45(2) **Where a financing change statement is registered under subsection (1) and an interest in part, but not all, of the collateral is transferred, the financing change statement shall contain a description of the collateral in which the interest is transferred.**

45(3) **Where a secured party transfers an interest in collateral and the security interest of the secured party is not perfected by registration, a financing statement may be registered in which the transferee is disclosed as the secured party.**

45(4) **A financing statement disclosing a transfer of a security interest may be registered before or after the transfer.**

45(5) **After registration of a financing change statement disclosing a transfer of a security interest, the transferee is the secured party for the purposes of this Part.**

45(6) **Where a security interest has been subordinated by the secured party to the interest of another person, a financing change statement may be registered to disclose the subordination at any time during the period that the registration of the subordinated interest is effective.**

COMMENTARY

Registration of a Transfer of a Security Interest

Under the existing law, a secured party is not required to amend its registration to disclose an assignment or transfer of its security interest, regardless of whether the transfer is effected by agreement or operation of law[1].

PPSA section 45(1) likewise makes it clear that where a secured party with a registered security interest transfers the interest, registration of a financing statement to disclose the transfer is permissive not mandatory. This makes sense. Failure to record a transfer of the security interest does not undermine its searchability since the principal search criterion is the name of the debtor, not the secured party.

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[1] This is implicitly recognized in *Conditional Sales Act* section 1 where "seller" is

The situation is quite different, of course, where the security interest which is transferred is not perfected by registration at the time of the transfer. Here, the transferee will want to register in order to perfect the security interest (unless the security interest is one that was perfected by possession and possession has also been transferred). Section 45(3) makes it clear that in such a case, a financing statement may be registered in the name of the transferee as the secured party. There is no need, in other words, to register in the name of the original secured party.

But even where the security interest is registered at the time of the transfer, registration of the transfer may be desirable. So long as it remains the secured party of record, the original secured party will be vulnerable to liability under section 18 in relation to third party requests for information on the current status of a registered security interest. Failure to record the assignment may also entail potential liability for the assignee of the security interest. Under section 18, the assignee will be estopped from denying the validity of information supplied by the original secured party pursuant to a demand by a third party unless the third party was advised of the assignment.

Registration of the transfer is effected by registering a financing change statement in the form to be prescribed by the regulations (section 45(1)). The transfer may be registered before or after it takes place (section 45(4)). Once the transfer is registered, the transferee becomes the secured party of record for the purposes of Part 4 (section 45(5)).

Registration of Subordination Agreements

Where a secured party agrees to subordinate or postpone a registered security interest to the interest of somebody else, section 45(6) authorizes registration of a financing change statement disclosing the subordination. Disclosure is permissive, not mandatory, since the subordination can affect only the priority position of the parties bound thereby who presumably already know its contents.

(continued)
defined to include "a successor in interest" of the original conditional seller or hirer.

SECTION 46

REMOVAL OF INFORMATION FROM REGISTRY

46(1) **Where a document is registered in the registry, the registrar may have the statement reproduced by any means and the reproduction is for all purposes deemed to be the document reproduced.**

46(2) **Information in a registration may be removed from the records of the registry**

(a) **when the registration is no longer effective,**

(b) **on the receipt of a financing change statement discharging or partially discharging the registration,**

(c) **if the secured party fails to submit to the registrar a court order maintaining the registration under section 50,**

(d) **on receipt of an order of a court compelling the discharge or partial discharge of a registration.**

COMMENTARY

Section 46(1) empowers the registrar to reproduce a registered document by any means (for instance, microfiche for storage or an optical scanner for entry into the registration data base) and deems the reproduction to be the document reproduced.

Section 46(2) empowers the registrar to remove registered information from the registry when it is no longer effective because of lapse or discharge, whether the discharge is voluntary or results from the compulsory discharge procedure under section 50.

NOTES

SECTION 47

REGISTRATION NOT CONSTRUCTIVE NOTICE

47 Registration of a financing statement in the registry is not constructive notice or knowledge of its existence or contents to any person.

COMMENTARY

Whether registration of a security interest is constructive notice to third parties is still unresolved in the existing law. The question is important because of the plethora of common law, equitable and statutory rules that make priority turn on whether a subsequent interest was acquired with notice of a previous interest[1].

The doctrine of constructive notice is irrelevant to the operation of the PPSA priority regime established by Part 3. In order to forestall the re-introduction of priority rules that rely on the concept of constructive notice, section 47 expressly provides that registration of a security interest does not constitute constructive notice of its existence.

But while constructive notice based on registration is irrelevant under the PPSA, taking with actual knowledge of a prior security interest will continue to affect priority in some instances under the Part 3 priority rules: see further the commentary on section 1(2).

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[1] For a detailed discussion of the existing law on priorities in general and the relevance of constructive notice in particular, see Catherine Walsh, "Principles of Priority", pp. 194-300 in Debt Security, New Brunswick Continuing Legal Education (November 1985). And see J.S. Ziegel, "Registration Statutes and the Doctrine of Constructive Notice" (1985) 63 Can Bar Rev 629.

NOTES

SECTION 48

REGISTRY SEARCHES

48(1) **A person may request one or more of the following**

- **(a) a search of the name of a debtor and the issue of a search result,**
- **(b) a search according to the serial number of goods of a kind that are defined in the regulations as serial numbered goods and the issue of a search result,**
- **(c) a search according to a registration number and the issue of a search result**
- **(d) a printed result of a search referred to in paragraphs (a) to (c),**
- **(e) a copy or certified copy reproduced on paper of any registered printed document.**

48(2) **A printed search result that purports to be issued by the Registry is receivable as evidence as *prima facie* proof of its contents including**

- **(a) the date of registration of a financing statement to which the search result refers, and**
- **(b) the order of registration of the financing statement as indicated by the registration number.**

48(3) **A copy of a registered financing statement or other registered document bearing the certification of the Registrar is receivable in evidence as a true copy of the statement or document without proof of the signature or official position of the Registrar.**

COMMENTARY

Searches - Method and Venues

In most PPSA jurisdictions, search requests may be made either in person or by fax, telephone, mail or courier. In British Columbia, clients who are registered account holders with BC OnLine may conduct searches themselves using direct remote access to the registry data base from their own personal computer terminals.

In New Brunswick, it is recommended that registry clientele be able to request searches: (1) at the Central Registry either in person or by mail, telephone, courier or fax, and (2) in person or by telephone at any land registry office, assuming implementation into these offices of the recommended remote electronic access system. In time, the remote access system should be extended to permit direct client searching, as in British Columbia.

Transition Searching

Under section 73, certain pre-PPSA security interests registered in the existing registries will be deemed to be registered and perfected under the PPSA for a maximum of three years following the coming into force of the Act. During this three-year transition period, credit searchers will have to conduct searches in both the new Registry and the existing registries. On the need for transition searching, see further the commentary on section 73.

Search Criteria

Under section 48(1), searches can be requested in the Personal Property Registry according to three search criteria:

(1) business or individual debtor name
(2) collateral serial number if the collateral is defined in the regulations as serial numbered goods
(3) PPSA registration number

A search by PPSA registration number is useful where a secured party wants to check the validity and history of its own registration. But in the more common case where the object of the search is to discover whether collateral in the possession of somebody is subject to a registered security interest, the relevant search criteria are debtor name or collateral serial number.

The individual or business name of the debtor, as the case may be, is a universal search criterion. Yet it is not always an adequate one. Suppose a debtor has purported to sell collateral subject to a registered security interest outright to a third party who proposes, in turn, to sell or grant security in it. Assuming the prospective purchaser or secured party is unaware that the third party acquired the collateral from the original debtor, he or she will search the registry using only the third party's name. That search will naturally not disclose the registered security interest. But a search according to serial number will, regardless of how many hands the collateral may have passed through.

In view of the superior protection it offers searchers, registration by serial number should be required in respect of all relatively 'large ticket' manufactured goods for which unique, accurate and permanently affixed identification numbers or marks are available. Yet the Ontario PPSA regulations require serial number registration only if the collateral is a motor vehicle (and motor vehicle is defined to exclude boats, aircraft, farm tractors and road building equipment). On this point, the New Brunswick PPSA regulations will instead incorporate the more expansive approach adopted by other jurisdictions which have implemented the Western Model. Following Saskatchewan's lead[1], the British Columbia and Alberta regulations define serial numbered goods to include motor vehicles[2], mobile homes, boats[3], outboard motors for boats, trailers and aircraft airframes, engines and propellers[4].

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[1] See Ronald Cuming, "Modernization of Personal Property Security Registries: Some Old Problems Resolved and Some New Ones Created" (1983-84) 48 Sask L Rev 189 at 196-8

[2] Under the Alberta PPSA regulations, motor vehicle is defined to include combines, tractors and road construction vehicles. Where the motor vehicle is an automobile or truck, the prescribed serial number under the regulations is the vehicle identification number (VIN) located on the body frame. For other types of motor vehicles and for mobile homes, trailers, and outboard motors, the prescribed serial number is the serial number affixed by the manufacturer.

Under both the Ontario and the Western Model PPSA, serial number registration is mandatory only if the serial numbered goods are classified as consumer goods. If they are classified as equipment, registration by serial number is optional. However, the Western Model (as implemented in British Columbia and Alberta and proposed for New Brunswick) gives secured parties a strong incentive to exercise that option. A secured party who fails to register the serial number of serial numbered goods held as equipment is protected only as against the debtor's execution creditors or trustee in bankruptcy. Buyers or lessees of the collateral will take free of the security interest[5] and it will be treated as unperfected as against other secured parties[6].

(continued)

[3] Where the collateral is a boat, the prescribed serial number for registration purposes is not the serial number affixed by the manufacturer but the registration, license or recording number assigned to it by the Ministry of Transport under the *Canada Shipping Act*. The serial number affixed by the manufacturer can be used only in the unlikely event that the boat is one that cannot be registered, recorded or licensed under the *CSA*.

[4] Where the collateral is an aircraft, the separate serial numbers of the airframe, engine and propellers must each be recorded. However, at its June 1991 meeting, the Canadian Conference on Personal Property Security Law was asked to amend the Western Model to delete the requirement for registration of the serial number of the aircraft engine. The request came from Canadian Airlines International Limited which rotates the engines among the aircraft in its fleet for maintenance purposes. Consequently, Canadian's aircraft are financed on the basis of "snap-on" provisions which provide for the security interest to automatically attach to the replacement engine when it is installed on the aircraft and to detach from the removed engine. Canadian's concern with mandatory engine serial number registration is the impracticality of having to file amendments to the serial number description of the engine attached to the financed aircraft every time the engine is rotated. Canadian's request is currently under consideration by the Legislative Review Committee of the Canadian Conference.

[5] See sections 30(6) and (7).

[6] See section 35(4)

If the serial numbered goods are inventory, serial number registration is not required nor is the secured party given lesser protection as against buyers or other secured parties. Here the values of commercial convenience and efficiency are thought to outweigh the risk to remote purchasers of the collateral. It would be unduly burdensome to require secured parties to register the serial number of every item of inventory going in and out of their debtor's stock. Moreover, the need to protect remote purchasers against the risks presented by multiple transfers of the collateral is much less acute where the serial numbered goods are inventory. If the registered security interest was created by the original debtor and the goods are sold in the original debtor's ordinary course of business, then the original buyer and her successors in interest will take free of the security interest in any event[7]. Even if the original debtor was not the seller but the person who supplied the goods for the seller's inventory, there is not likely to be much risk to the second buyer. If the goods were acquired by the original debtor as consumer goods or equipment, then they will be subject to mandatory serial number registration and the second buyer can protect herself by a serial number search. And even if they were acquired by the original debtor as inventory and therefore not subject to serial number registration, remote purchasers will be vulnerable only if the first transfer took place out of the ordinary course of business of the original debtor.

Evidentiary Aspects of Documents issued by the Registry

Sections 48(2) and (3) are included in the interests of promoting efficient dispute resolution by discouraging unnecessary requests for strict proof. Under section 48(2), a printed search result that purports to be issued by the registry is receivable in evidence as *prima facie* proof of its contents. And under section 48(3), a copy of any registered document that bears the certification of the registrar is receivable in evidence without proof of the signature or official position of the registrar.

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[7] See further the commentary on section 30(2)

SECTION 49

FIXTURES AND GROWING CROPS REGISTRATIONS IN THE (LAND) REGISTRY OFFICE

49(1) In this section,

(a) "debtor" includes any person named in a notice under this section as a debtor,

(b) "secured party" includes any person named in a notice under this section as a secured party.

49(2) A security interest in a fixture under section 36, and a security interest in a growing crop under section 37 may be registered by tendering a notice in the prescribed form signed by the secured party and accompanied by the prescribed fee to the land registry office for the appropriate county or the land titles office for the appropriate land registration district, as the case may be, and the registrar of the office to which the notice is tendered shall register the notice in the records of the land registry office or the title register of the land titles office, as the case may be.

49(3) The registration of a notice under subsection (2) is notice of the security interest to every person dealing with the land to which the notice relates.

49(4) Subsections 43(4), (5), (6), (8), (9) and (12) and sections 44 and 45 apply with all necessary modifications to a notice registered under subsection (2).

49(5) After its expiry date, if any, a notice registered under subsection (2) is of no effect and the appropriate registrar may cancel entry of the notice, and any other notice that relates to the same security interest, in the records of the land registry office or the title register of the land titles office, as the case may be.

49(6) On receipt of a notice of cancellation in the prescribed form signed by the secured party and accompanied by the prescribed fee, the appropriate registrar shall, subject to subsection (8), cancel entry of the notice under subsection (2) to which the notice of cancellation relates, and any other notice that relates to the same security interest, in the records of the land registry office or the title register of the land titles office, as the case may be.

49(7) Subject to subsection (8), on registration of a notice of cancellation under subsection (6), the notice registered under subsection (2) to which the notice of cancellation relates is of no effect.

49(8) Where a notice of cancellation under subsection (6) is expressed to be a partial cancellation, the appropriate registrar shall register the notice in the records of the land registry office or the title register of the land titles office, as the case may be, whereupon the notice registered under subsection (2) to which the notice of cancellation relates is of no effect in relation to the collateral and land to which the partial cancellation extends.

49(9) Where a notice is registered under this section and

(a) all of the obligations under the security agreement to which the notice relates have been performed,

(b) the secured party has agreed to release part or all of the collateral described in the notice,

(c) the description of the collateral contained in the notice includes an item or kind of property that is not collateral under a security agreement between the secured party and the debtor,

(d) no security agreement exists between the secured party and the debtor, or

(e) the collateral described in the notice is not affixed to the land to which the notice relates,

the debtor named in the notice and any person having a registered interest in the land may give a written demand to the secured party.

49(10) A demand referred to in subsection (9) may require that the secured party, not later than 40 days after the demand is given, either

(a) submit for registration a notice in the prescribed form

(i) discharging the registration of the notice, in a case falling within subsection 9(a), (d) or (e),

(ii) amending or discharging the registration f the notice to reflect the terms of the agreement, in a case falling within subsection 9(b), or

(iii) amending the collateral description on the notice to exclude items or kinds of property that are not collateral under a security agreement between the secured party and the debtor, in a case falling within subsection 9(c),

or

(b) submit for registration an order of the Court confirming that the registration need not be amended or discharged.

49(11) If a secured party fails to comply with a demand referred to in subsection (9), the person giving the demand may submit for registration the notice referred to in subsection 10(a) and the registrar of the land registry office or the land titles office, as the case may be, shall register the notice on receiving satisfactory proof that the demand has been given to the secured party.

49(12) A demand referred to in subsection (9) may be given in accordance with section 69 or by registered mail addressed to the address of the secured party as it appears on the notice registered under this section.

49(13) Subsections 50(6) to (8) apply with all necessary modifications to a notice registered under this section.

49(14) **No fee or expense shall be charged and no amount shall be accepted by a secured party for compliance with a demand referred to in subsection (9), unless the charge has been agreed to by the parties before the making of the demand.**

COMMENTARY

Purpose

Although the PPSA applies to security interests in fixtures, section 36 requires that a notice of the fixtures interest be registered in the appropriate land registry or land titles office in order to preserve priority against various third party interests in the underlying realty. Section 37 establishes a similar regime for security interests in growing crops, excluding trees. Section 49 deals with the mechanics of registering, renewing, amending and discharging such notices[1].

Registration, Renewal and Amendment of Notices

Under section 49(2), registration of a fixtures or crops interest is effected simply by tendering a notice of security interest to the land registry office or the land titles office, as the case may be, for the area in which the land to which the collateral is or is about to be affixed is located. The notice must be signed by the secured party and accompanied by the prescribed fee.

The form of the notice of security interest to be used under section 49(1) will be prescribed by the PPSA regulations. Under the proposed regulations, the notice will have to contain the basic information necessary to alert searchers to the existence and nature of the interest. This includes the name and address of both the secured party and the debtor, a description of the collateral by which it may be readily identified, the expiry date of the notice and, most importantly, a description of the relevant land sufficient for the purpose of identifying it in the records of the land registry office or the title register of the land titles office[2].

The problem of ensuring that the fixtures filing is indexed in the realty records in such a way as to be capable of being found by a searcher is complicated in New Brunswick because of the existence of two different real property registration systems.

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[1] The procedures for registering and discharging a notice of a crops or fixtures interest against land established by section 49 are a refined version of the procedures established by section 17 of the existing *Conditional Sales Act* for registering and discharging a notice of a conditional sales agreement covering fixtures against land.

[2] Compare the more prolix filing requirements presently dictated by section 17(4) and (5) of the *Conditional Sales Act* which require that the notice set out the amount remaining unpaid under the conditional sales agreement and that it be accompanied by a copy of the conditional sales agreement as well as an affidavit by the seller verifying the notice. While the land registry system in New Brunswick is a documentary filing system, there is no reason not to change to notice filing for fixtures and crops interests. As in the case of notices registered in the Personal Property Registry, credit searchers in the land registry system can simply contact the secured party of record to find out the current status of the fixtures or crops interest, something which they have to do presently in any event if they need to know the cur-

Searches in the *Land Titles Act* system, which is presently in force in Albert County only, are conducted according to parcel index number. Accordingly, where the relevant land is registered under the *Land Titles Act*, the regulations will require that the notice of security interest set out a specific description of the land by its parcel index number.

Searches in the traditional *Registry Act* system are conducted in a grantor/grantee index. In some cases, the debtor's name may not appear in the chain of title to the realty, for instance, if the debtor under the fixtures or crops interest is a non-registered lessee of the land. To resolve this problem, the regulations will prescribe that where the debtor does not have a registered interest in the land, the notice of security interest must set out the name of the registered land owner in addition to the debtor and the notice must be indexed in the registry records under the name of the record owner as well as the debtor.

Section 49(4) provides that subsections 43(4), (5), (6), (8), (9) and (12) and sections 44 and 45, dealing with financing statements registered in the Personal Property Registry, apply with all necessary modifications to a notice registered against land under section 49. Thus:

> The notice may be registered against the land before the security agreement is made and before the security interest attaches (subsection 43(4)).
>
> The registration of the notice may relate to more than one security agreement (section 43(5)).
>
> Where there is an error or omission in the notice, the test for determining whether this renders the registration against the land invalid is the same as for financing statements registered in the Personal Property Registry (subsection 43(6), (8) and (9)).
>
> The secured party must give the debtor a copy of the notice within 30 days after it is registered (subsection 43(12)).
>
> Finally, the rules governing the registration life of a notice registered against land under section 49, and its renewal or amendment, including amendments to record a transfer or subordination, are the same as those set out in sections 44 and 45 for financing statements. However, the document which will be prescribed under the regulations for renewing or amending the notice will be called a notice of extension or notice of amendment rather than a financing change statement.

Cancellation and Discharge of Notices

Section 49(5) empowers the registrar of a land registry office or land titles office to cancel entry of a registered notice of security interest after its expressed expiry date has passed.

Subsections 49(6) to (8) empower the registrar to cancel entry of a registered notice on receipt of a notice of cancellation signed by the secured party. Where the notice of cancellation is expressed to be partial only, the effect of the cancellation is limited to the collateral and land to which the partial cancellation relates. The form of notice of cancellation which will be prescribed under the regulations will require the secured party to set out the registration number of the notice to be cancelled as well as to give a description of the land affected by the notice sufficient to enable the registrar to identify it in the records[3].

(continued)
rent amount outstanding on the conditional sales agreement.

Subsections 49(9) to (13) establish procedures for enforcing a compulsory discharge or amendment of a notice registered against land under section 49[4] which are similar to those available under section 50 for registrations in the Personal Property Registry. An inexcusable failure to comply with section 49 in this respect will expose the secured party to liability for deemed damages under section 66.

(continued)

[3] Subsections 49(6) to (8) are comparable to subsections 17(15), (16) and (18) of the *Conditional Sales Act* in the existing law.

[4] Under the existing law, see sections 17(15)(b) and 17(17) of the *Conditional Sales Act* for the procedures for enforcing registration of a discharge of a fixtures notice registered against land.

NOTES

SECTION 50

COMPULSORY DISCHARGE OR AMENDMENT OF REGISTRATION

50(1) In this section,

(a) "debtor" includes any person named in a registered financing statement as a debtor,

(b) "secured party" includes any person named in a registered financing statement as a secured party.

50(2) Where a registration relates exclusively to a security interest in consumer goods, the secured party shall discharge the registration not later than 30 days after all obligations under the security agreement creating the security interest are performed, unless prior to the expiry of that 30 day period the registration lapses.

50(3) Where a financing statement is registered and

(a) all of the obligations under the security agreement to which it relates have been performed,

(b) the secured party has agreed to release part or all of the collateral described in the financing statement,

(c) the description of the collateral contained in the financing statement includes an item or kind of property that is not collateral under a security agreement between the secured party and the debtor, or

(d) no security agreement exists between the secured party and the debtor,

the debtor or any person with an interest in property that falls within the collateral description on the financing statement may give a written demand to the secured party.

50(4) The demand referred to in subsection (3) may require that,

(a) in a case within subsections (3)(a) or (d), the registration be discharged,

(b) in a case within subsection (3)(b), the registration be amended or discharged as the case may be, so as to reflect the terms of the agreement, and

(c) in a case within subsection (3)(c), the collateral description be amended to exclude items or kinds of property that are not collateral under a security agreement between the secured party and the debtor,

and the secured party shall amend or discharge the registration accordingly not later than 15 days after the demand is given.

50(5) **If the secured party fails to amend or discharge the registration as required in subsection (4), the person giving the demand may require the Registrar to give a notice in writing to the secured party stating that the registration will be discharged or amended, as the case may be, in accordance with the demand on the expiry of 40 days after the day the Registrar gives the notice to the secured party, unless in the meantime the secured party registers an order of a court maintaining the registration.**

50(6) **If the secured party fails to amend or discharge the registration as required by subsection (4) or fails to tender to the registrar a court order maintaining the registration, the Registrar may discharge or amend the registration in accordance with the demand on the expiry of 40 days after the day the Registrar gives the notice to the secured party as provided in subsection (5) or as soon thereafter as possible.**

50(7) **The demand referred to in subsection (4) and the notice referred to in subsection (5) may be given in accordance with section 69 or by registered mail addressed to the secured party as it appears on the financing statement.**

50(8) **On application to a court by the secured party, the court may order that the registration**

(a) **be maintained on any conditions, and subject to section 44, for any period of time, or**

(b) **be discharged or amended.**

50(9) **Subsections (5) and (6) do not apply to a registration of a security interest provided for in a trust indenture if the financing statement through which the security interest was registered indicates that the security agreement providing for the security interest is a trust indenture.**

50(10) **Where a registration relates to a security interest created under a trust indenture and the secured party fails to amend or discharge the registration as required by subsection (4) the person making the demand may apply to a court for an order directing that the registration be amended or discharged.**

50(11) **No fee or expense shall be charged and no amount shall be accepted by a secured party for compliance with a demand made under subsection (3), unless the charge has been agreed to by the parties before the making of the demand.**

COMMENTARY

Secured Party's Duty to Register a Discharge of a Consumer Goods Registration

Under subsection 50(2), the secured party is under a statutory onus to register a discharge where a registration relates exclusively to consumer goods. The registration must be discharged within 30 days after all the obligations under the security agreement have been met. The only exception is where the registration is due to lapse in any event before the expiry of the 30 day period.

Debtor's Right to Demand Discharge or Amendment of a Registration

Where the registration does not relate exclusively to consumer goods, section 50 does not impose any statutory obligation on the secured party to register a discharge. This is because commercial financing is typically a medium to long term arrangement, usually involving a fluctuating line of credit rather than a lump sum loan and a series of security agreements rather than a one-time loan or credit transaction. Accordingly, it would be contrary to the interests and intentions of both parties to require the secured party to register a discharge every time there was a thirty day break in their financing relationship.

However, even commercial financing arrangements do come to an end at some point. And there is always the possibility that the negotiations fell apart after registration and no security agreement was in fact ever executed. In the event the secured party is unwilling or neglects to register a discharge, section 50(3) accordingly empowers the debtor or any person with an interest in the collateral to demand that the registration be discharged where:

(1) all of the obligations under the security agreement to which the registration relates have been performed;
(2) the secured party has agreed to release all of the collateral described in the security agreement; or
(3) no security agreement exists between the parties.

If the secured party does not comply within 15 days, the person making the demand may then bring in aid the weight of officialdom. Under section 50(5), the registrar can be required to give a notice in writing to the secured party of record to discharge the registration in accordance with the demand. To maintain registration, the secured party must apply under section 50(9) for a court order to that effect and must register it within 40 days after receiving the registrar's demand. Otherwise, section 50(6) requires the registrar to discharge the registration as soon as possible after the expiry of the 40 day period unless the secured party itself has already done so.

The demand procedure established by section 50 can also be used to force a secured party to amend its registration so as to reflect the true nature of the current arrangement between the parties where:

(1) the secured party has agreed to release part of the collateral described in a financing statement; or
(2) the description of the collateral contained in the financing statement includes an item or kind of collateral that is not collateral under a security agreement between the secured party and the debtor.

Notice of Discharge

As is presently done in other PPSA jurisdictions, the registrar of the New Brunswick personal property registry will send a discharge verification statement to the secured party of record and to the registrant if different. If the discharge was unauthorized or made in error, the secured party should notify the registry immediately and re-register within 30 days of the discharge in order to maintain its perfected status for the purpose of priority: see the commentary on section 35(7).

NOTES

SECTION 51

TRANSFER OF DEBTOR'S INTEREST IN COLLATERAL OR CHANGE OF DEBTOR'S NAME

51(1) Where a security interest has been perfected by registration and the debtor transfers all or part of the debtor's interest in the collateral with the prior consent of the secured party, the security interest in the transferred collateral is subordinate to

(a) an interest, other than a security interest in the transferred collateral, arising in the period from the expiry of the 15th day after the transfer to, but not including, the day the secured party amends the registration to disclose the name of the transferee of the interest in the collateral as the new debtor or takes possession of the collateral,

(b) a perfected security interest in the transferred collateral registered or perfected in the period referred to in clause (a), and

(c) a perfected security interest in the transferred collateral registered or perfected after the transfer and before the expiry of the 15th day after the transfer if, before the expiry of the 15 days,

(i) the registration of the security interest first referred to in this subsection is not amended to disclose the transferee of the interest in the collateral as the new debtor, or

(ii) the secured party does not take possession of the collateral.

51(2) Where a security interest is perfected by registration and the secured party has knowledge of

(a) information required to register a financing statement showing the transferee as the new debtor, where all or part of the debtor's interest in the collateral is transferred, or

(b) the new name of the debtor, where there has been a change in the debtor's name,

the security interest in the transferred collateral, where paragraph (a) applies, and in the collateral where paragraph (b) applies, is subordinate to

(c) an interest, other than a security interest, in that collateral, arising in the period from the expiry of the 15th day after the secured party has knowledge of information referred to in paragraph (a) or the new name of the debtor, as the case may be, to, but not including, the day the secured party amends the registration to name the transferee as the new debtor, or to indicate the new name of the debtor, as the case may be, or takes possession of the collateral,

(d) a perfected security interest in the collateral registered or perfected in the period referred to in paragraph (c), or

(e) a perfected security interest in the collateral registered or perfected after the secured party had knowledge of the information referred to in paragraph (a) or the new name of the debtor, as the case may be, and before the expiry of the 15th day referred to in paragraph (c), if, before the expiry of the 15 days,

(i) the registration of the security interest first mentioned in this subsection is not amended to disclose the transferee of the collateral as the new debtor or to disclose the new name of the debtor, as the case may be, or

(ii) the secured party does not take possession of the collateral.

51(3) This section does not have the effect of subordinating a prior security interest under prior registration law deemed under section 73 to be registered under this Act.

51(4) Where the debtor's interest in part or all of the collateral is transferred by the debtor without the consent of the secured party and there are one or more subsequent transfers of the collateral without the consent of the secured party before the secured party acquires knowledge of the name of the most recent transferee of the collateral, the secured party shall be deemed to have complied with subsection (2) if the secured party registers a financing statement not later than 15 days after acquiring knowledge of

(a) the name of the most recent transferee of the collateral, and

(b) the information required to register a financing change statement,

and the secured party need not register financing change statements with respect to any intermediate transferee.

COMMENTARY

Purpose

Under both the existing law and the PPSA, there is no need to amend a registration to disclose that the secured party has transferred its security interest in the collateral. Disclosure is permissive not mandatory[1]. This makes sense. A transfer of the security interest does not undermine its searchability since the principal search criterion is the name of the debtor, not the secured party.

Existing law also does not require disclosure if the debtor transfers its interest in the collateral. But unlike a transfer of the secured party's interest, a transfer of the debtor's interest undermines the publicity and evidentiary functions of the registry system. So does a change in the debtor's name subsequent to the initial registration. The debtor's name is the principal search criterion[2] and a search using the debtor's new name or the name of the debtor's transferee will not disclose an interest registered against the old name or the original debtor. If credit searchers are to be adequately protected, the secured party should be obliged to amend its registration to disclose the new status or otherwise reperfect its security interest. This is the purpose of section 51.

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[1] See further section 45.

Transfer of Debtor's Interest with Prior Consent of Secured Party

Section 51(1) addresses the case where the secured party gives its prior consent to a transfer by the debtor of all or part of the debtor's interest in collateral that is subject to a registered security interest. Within fifteen days of the transfer, the secured party must, in effect, reperfect its security interest by either amending its registration to disclose the transferee as the new debtor or taking possession of the collateral. The new Ontario PPSA[3] and the Western Model PPSA are much the same on this point and clear up a number of the drafting deficiencies found in the older PPSA's[4].

Transfer of Collateral Without the Consent of the Secured Party and Change in Debtor's Name.

Where the secured party does not consent to the transfer of the collateral by the debtor, it is unlikely to have advance knowledge of the event. So too where the debtor changes its name[5] subsequent to the original registration. There is no question that these changes still present a risk to third parties who deal with the debtor under her or his new name or with the debtor's transferee, as the case may be. However, it would be unfair to impose a reperfection obligation on a secured party in relation to a change in circumstances of which it is still ignorant. The perfected status of its security interest would not be worth much if this were the rule. Accordingly, section 51(2) does not oblige the secured party to reperfect unless and until it "has knowledge of information required to register a financing change statement disclosing the transferee as the new debtor...or the name of the new debtor", as the case may be. Once the required knowledge threshold is met, the secured party is again given 15 days to either take possession of the collateral or amend its registration to disclose the transferee as the new debtor or the new name of the debtor, as the case may be[6].

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[2] See further the commentary on section 48.

[3] Section 48(1)

[4] Under section 49(1) of the Saskatchewan PPSA, for instance, the secured party is required to amend its registration forthwith upon a transfer to which it has given its prior consent. This approach can create compliance problems for the secured party since it allows no time to ascertain the details of the transfer including the precise name of the transferee. While section 50(1) of the Manitoba PPSA provides a fifteen day compliance period, time begins to run from when the secured party "consents to the transfer" rather than from when the transfer is made. This difference makes the provision of a fifteen day compliance period illusory where consent is given more than fifteen days prior to the transfer. Section 49(1) of the old Ontario PPSA posed the same problem. Finally, neither the Saskatchewan not the Manitoba provisions are expressly restricted to cases where the secured party has given its *prior* consent to the transfer, an omission which potentially gives rise to interpretative difficulties in the event of a retroactive consent.

[5] Note that in *Re Yustin Construction* (1986) 5 PPSAC 154 (Ont SC), it was held that a corporate amalgamation, in which the amalgamated company's name differed from one or more of the amalgamating companies, resulted in a name change within the meaning of the PPSA.

The new Ontario PPSA[7] and the Western model PPSA are substantially similar on this point as well except that the time period for compliance under the Ontario version is extended to thirty days. There are also significant differences in drafting style which may imply a greater difference in substantive effect than is actually the case. In particular, the Ontario version distinguishes between the case where the secured party has prior knowledge of the transfer and possesses the relevant information at the point of transfer to effect the required amendment and the case where it learns of the transfer only after the fact. In the former case, it must reperfect within thirty days of the transfer while in the latter case the thirty days does not start to run until the secured party acquires the relevant information, however long that may be after the transfer[8]. Section 51(2) of the Western Model is worded in such a way as to make any express distinction of this sort unnecessary[9].

When does a Secured Party have Knowledge of a Transfer or a Debtor Name Change?

In determining when a secured party acquires sufficient knowledge to trigger its reperfection obligation under section 51(2), see section 1(2) which provides general guidance on when a person, partnership and corporation or association respectively "knows or has knowledge" of something for the purposes of the PPSA[10].

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[6] Under section 51(1) of the Manitoba PPSA, the secured party is not obligated to reperfect if it learns that the debtor has changed its name. Registration of the new name is permitted but not mandatory. However, the secured party must register the name of the new transferee as debtor if it learns that the debtor has transferred the collateral: section 50(2). All of the other PPSA's require reregistration or reperfection in both events. Under s. 49(2) of the Saskatchewan PPSA, however, time begins to run as soon as the secured party receives notice of the transfer or the debtor's change of name. There are two problems with this wording. Firstly, it allows the secured party no time period for adjustment. Secondly, a secured party may have knowledge of a transfer or change of name but not yet know the name of the debtor or the transferee and therefore be incapable of making the required amendment.

[7] Ontario s. 48(2)

[8] Section 49(2) of the Saskatchewan PPSA uses a similar drafting technique for both debtor name changes and transfers.

[9] If the secured party learns of an impending name change or transfer, it may of course register its amendment before the change or transfer actually takes place notwithstanding that the time period for compliance does not start to run until the change has actually taken place: *Re Key National Leasing Ltd.* (1989) 9 PPSAC 32 (Ont SC)

[10] Under section 49(2) of the Saskatchewan PPSA, time begins to run when the secured party "receives notice" of the relevant event. The Ontario and Manitoba PPSA's use the word "learns". Both the Saskatchewan and Ontario Acts provide statutory guidance on the meaning of learns and notice respectively while the Manitoba Act leaves the concept of "learns" to judicial development. While these differences are not likely to loom large, they must be kept in mind in judging the exportability of caselaw on the issue from one jurisdiction to another. For cases on the issue, see: *Re Simi Ltd.* (1987) 7 PPSAC 100 (Ont SC) and *Re Country Kitchen Donuts Ltd* (1980) 1 PPSAC 176.

Successive Transferees.

The older PPSA's do not expressly address the question of the secured party's reperfection obligation where there are successive transfers of the collateral without the secured party's consent prior to the secured party learning the name of any of them. It would be akin to 'locking the barn door after the cow has been stolen' to require the secured party to register the name of each and every preceding transferee where it does not become aware of them until after the collateral has already passed to a new successor in title. Accordingly, section 51(4) expressly provides that the secured party is deemed to have met its obligations under 51(2) if it registers the name of the most recent transferee within fifteen days after acquiring the knowledge necessary to make the amendment and expressly releases the secured party from any registration obligation with respect to any intermediate transferee.

Priority Consequences of Secured Party's Failure to Reperfect before Expiry of 15 Day Compliance Period

Under the Ontario PPSA, failure to reperfect before the expiry of the prescribed time period causes the security interest to became unperfected[11]. The security interest may, however, be reperfected by registering a financing change statement[12] at any time during the remainder of the unexpired registration period of the financing statement or any renewal thereof. Once the security interest is reperfected, the lapse in perfected status is not necessarily prejudicial to the secured party's priority status *provided* no third party rights arose during the lapse period[13]. The interest is deemed upon reperfection to have been continuously perfected from the time of first perfection except in respect of any person who acquired rights in the collateral during the period that the interest was unperfected[14]. In other words, reregistration following a lapse in perfected status caused by a failure to record a transfer or change of name has the same effect under the Ontario PPSA as reregistration following a lapse caused by the expiration of registration.

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[11] Thus, the non-complying secured party will be subordinated in the event of a subsequent bankruptcy: *Re Alduco Mechanical Contractors* (1979) 1 PPSAC 142 (Ont SC)

[12] Even though the perfected status of the security interest has lapsed, the interest can be reperfected by registering a financing change statement rather than a financing statement since the purpose of the registration is to amend an original registration which remains on the record and to which the amendment can therefore still be cross-referenced. In *Re 360081 Ont. Ltd.; Re Patenaude*, a decision under section 49(1) of the old Ontario PPSA, the secured party used a financing statement rather than a financing change statement to register a transfer of the collateral to which it had given its prior consent. Subsequently, both the original debtor and the transferee became bankrupt and the trustee in bankruptcy challenged the secured party's priority. It was held that the use of the wrong form could not be cured and by operation of section 49(1) the security interest became unperfected and remained so at the date of the bankruptcy. Accordingly, the trustee had priority under section 22(1)(a)(iii). Arguably, the result would be different under the new Ontario PPSA. Under the old Act, a financing statement had to be registered within thirty days after the security agreement was signed by the debtor. Section 45(3) of the new Act brings the Ontario practice into line with other PPSA jurisdictions by permitting registration of a financing statement at any time. Accordingly, the registration of a fresh financing statement should at least take effect under the new Act as a fresh act of perfection, enabling the secured party to retain its security interest against a trustee in bankruptcy. However, in a contest with another secured party where maintaining continuity of perfection is relevant, the use of the wrong form could still destroy priority rights.

[13] In *Re Media Corporation* (1984) 3 PPSAC 253 (Ont SC), the secured party did not file its amendment correcting the debtor's name until one day after a petition in bankruptcy was filed and it therefore lost out to the trustee in bankruptcy. There was another secured party in the picture who retained its priority against the trustee notwithstanding that it too had

The Manitoba PPSA also adopts the same approach to a lapse in perfection caused by a failure to update the registry following a transfer of the collateral as it does to a lapse caused by an expired registration. The reregistration after lapse restores the secured party's perfected status only from the date of reperfection with no relation back to the original registration. Thus the secured party will lose its pre-lapse priority ranking as against other secured parties[15].

Under the Saskatchewan PPSA, however, the priority consequences of failing to register a transfer or name change are quite different from the priority consequences of failing to renew registration. The security interest becomes unperfected upon expiration of the prescribed time period for compliance only as against interests arising *subsequent* to the transfer or change of name. If the transfer or name change is eventually registered, the difference between the Ontario and the Saskatchewan approaches is inconsequential. In both cases, the lapse will prejudice the secured party only in respect of interests arising during the period of lapse. However, if registration is never made, the results will be different in a contest between the noncomplying secured party and interests arising prior to the lapse. Under the Ontario approach, the secured party will lose out against pre-lapse interests even though they could not have been prejudiced by the failure to amend. But under the Saskatchewan approach, the secured party retains whatever priority it enjoyed against prior interests at the point of lapse.

The Saskatchewan approach more fairly reflects the purpose of requiring disclosure: to protect third party searchers dealing with a transferee from the original debtor or with the original debtor under its new name.

While agreeing in principle with the Saskatchewan approach, the drafters of the Western Model PPSA thought it expressed more a rule of priority than one of perfection since the effect of noncompliance is to subordinate the secured party to subsequent interests only. Its original perfected status is left unimpaired as against prior interests. Accordingly, while section 51 of the Western Model PPSA adopts the Saskatchewan approach, it takes this conceptual distinction into account. Failure to amend during the prescribed period causes the security interest to be subordinated to, rather than unperfected against, subsequent interests.

Priority as against Third Party Interests Arising during the Fifteen Day Compliance Period: Absolute or Conditional Protection?

Conceptually, the 15 day compliance periods provided under section 51 are most accurately described as "grace periods" since their effect is to preserve the secured party's priority status during that period. The compliance periods provided by section 48 of the Ontario PPSA are more accurately classified as periods of temporary perfection since their effect is to maintain the secured party's perfected status during that period.

Should a "grace period" or a period of "temporary perfection" offer absolute or conditional protection to the secured party? If absolute, then the secured party will retain its

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(continued)
not registered an amendment. However, the other secured party had the good fortune not to know of the name change.

[14] Section 30(6)

[15] *Assiniboine Credit Union Ltd v CIBC* (1983) 3 PPSAC 177 (Man QB)

priority or perfected status, as the case may be, until the expiration of the prescribed time period even though it ultimately does not comply with whatever registration obligation is cast on it. If conditional, then the secured party's ultimate noncompliance means that its priority or perfected status will be retroactively lost as of the date of commencement of the grace period or period of temporary perfection. The question of absolute or conditional protection becomes critical in cases where a third party interest arises in the collateral during the grace period or temporary perfection period as the case may be[16].

Although the Ontario PPSA does not expressly address the issue, the literal wording of section 48 suggests that the secured party's perfected status is preserved for all purposes until the expiry of the time period for reperfection regardless of whether or not the period expires without reperfection having occurred. Under section 48, the security interest only "becomes unperfected after" the expiry of the time period prescribed for reperfection. The Saskatchewan Court of Appeal interpreted similar wording as intended to provide absolute protection albeit in a different context[17].

An absolute protection rule can inject an undesirable and unjustified element of arbitrariness into the system. It is one thing to protect the secured party against third party interests that happen to arise during a "grace period" or "temporary perfection" period if the secured party perfects or reperfects before the expiration of that period. That is the whole purpose of giving a time period for compliance in the first instance. But where the secured party does not comply, why should it still gain the benefit of the compliance period?

Accordingly, section 51 of the Western Model makes it clear that the protection afforded the secured party against competing security interests which are registered or perfected during any of the fifteen day periods is conditional on reperfection prior to the expiry of the period. The overall result is that if the secured party fails to reperfect in time, it will be subordinated to subsequent perfected security interests in the same collateral regardless of whether the interest was registered or perfected within or outside the fifteen day period.

However, should a bankruptcy occur during the fifteen day period, the secured party will not be obliged to reperfect in order to maintain its rights in the collateral as against the trustee. Section 51 makes it clear that, as against third party interests other than other security interests, failure to reperfect subordinates the noncomplying creditor only if the interest arises after the expiry of the 15 day compliance period. As against non-security third party interests, in other words, the 15 day compliance period provides absolute protection. The difference in treatment is justified because of the somewhat arbitrary dating of bankruptcy, because creditors do not rely on the registry in the same way as do transferees of an interest in the collateral and because, once bankruptcy has taken place, there is little practical value left to compelling public disclosure of the security interest.

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[16] Under the existing law, the issue of conditional versus absolute protection arises most commonly under the *Conditional Sales Act*, which allows conditional sellers a thirty day "grace period" to register following signing of the conditional sales agreement and to reregister following removal of the collateral to a different registration district.

[17] In *Central Refrigeration & Restaurant Services v. CIBC* (1986) 5 PPSAC 262 (Sask CA), it was held that a security interest in proceeds was perfected as of the date of bankruptcy where bankruptcy occurred during the period of temporary perfection afforded for perfecting a security interest in proceeds even though the secured party's perfected status lapsed upon expiry of the period. Compare *Royal Bank v. Anderson* (1986) 6 PPSAC 252 (Sask QB).

Protection of Buyers or Lessees of the Collateral who take their Interest during a Fifteen-day Compliance Period

Unlike the new Ontario PPSA, the Western Model provides comprehensive protection to a buyer or lessee of the collateral who buys or leases without knowledge of a security interest during any of the fifteen day grace periods or periods of temporary protection provided by the Act, including a security interest the perfected status of which is maintained during any of the fifteen day compliance periods established by section 51[18].

Transitional Consideratons

Under 51(3), security interests that are registered in the existing registry systems when the PPSA comes into force, and that are deemed by section 73 to be registered under the PPSA, will not be subject to the requirements of section 51. Since prior registrations will physically remain in the old registry systems, there will not be any registration in the Personal Property Registry to which the section 51 amendment obligations could attach.

Proposed Variation of Section 51?

A proposal will be made to the Canadian Conference on Personal Property Security to amend the Western Model so as to make it clear that failure to comply with section 51 renders the security interest ineffective against the debtor's trustee in bankruptcy. While this is no doubt the intention, the present wording of section 51 may support an argument to the contrary. Under section 51, noncompliance causes the security interest to be subordinated to subsequent interests in the collateral. The word subordination is appropriate where the competing interest is a subsequent transferee of the collateral or a judgment creditor. But where the competing claimant is the trustee, the use of the word subordination in section 51 conflicts with the terminology used in PPSA section 20 which refers to an unperfected security interest being ineffective against the trustee rather than subordinate to her or his interest.

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[18] See further the commentary on section 30(5).

SECTION 52

RECOVERY OF LOSS CAUSED BY ERROR IN REGISTRY

52(1) **A person may bring action against the registrar to recover loss or damage suffered by that person because of an error or omission in the operation of the registry if the loss or damage resulted**

- **(a)** **from reliance on a printed search result, or**
- **(b)** **except as provided by subsections 43(3) and 43(10), the failure of the registrar to register a printed financing statement submitted for registration as provided in section 43.**

52(2) **No action for damages under this section or section 53 lies against the registrar unless it is commenced not later than**

- **(a)** **two years after the person entitled to bring the action first had knowledge of the loss or damage, or**
- **(b)** **ten years from the date the printed search result was issued or the financing statement was submitted for registration as the case may be,**

whichever is earlier.

52(3) **Notwithstanding the *Proceedings Against the Crown Act*, no action may be brought against the Crown in right of the Province, the registrar or an officer of employee of the registry for any error or omission of the registrar or an officer or employee of the registry in respect of the discharge or purported discharge of any duty or function under this Act, the regulations or under any other Act except as provided in this section and in section 53.**

COMMENTARY

Liability of Registrar for Loss or Damage

Section 52 establishes and demarcates the registrar's potential liability in the event that loss or damage is suffered by a person as a result of an error or omission in the operation of the registry.

The combined effect of subsections 52(1) and (3) is to limit the registrar's liability to loss or damage suffered by a person as a result of reliance on a *printed* search result or as a result of the registrar's failure to register a *printed* financing statement submitted pursuant to section 43. The registrar is not liable, in other words, for loss caused by an alleged error in the system suffered by a person who conducts a registration using, or who relies on a search result communicated by, a remote electronic communication system (should direct client access be made available) or who relies on a verbally-communicated search result. This qualification on liability is necessary because of the inevitable evidentiary difficulties that would arise in the absence of printed documentation.

Limitation of Action

Under section 52(2), the limitation period for bringing action against the registrar is two years running from when the plaintiff first acquires knowledge[1] of the loss or damage. This is subject to an outside limit of ten years from when the printed search result was issued or the financing statement was submitted for registration as the case may be.

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[1] See section 1(2) on the meaning of "knowledge".

SECTION 53

RECOVERY OF LOSS WHERE TRUST DEEDS INVOLVED

53(1) **An action for recovery of damages under section 52 brought by a trustee under a trust indenture or by a person with an interest in a trust indenture shall be brought on behalf of all persons with interests in the same trust indenture, and the judgment in the action, except to the extent that it provides for a subsequent determination of the amount of damages suffered by each person, constitutes a judgment between each person and the registrar in respect of each error or omission.**

53(2) **In an action brought by a trustee under a trust indenture or by a person with an interest in a trust indenture, proof that each person relied on the search result is not necessary if it is established that the trustee relied on the search result, but no person is entitled to recover damages under this section if the person knows at the time of acquisition of an interest in the collateral that the search result relied upon by the trustee is incorrect.**

53(3) **In proceedings under this section, a court may make any order that it considers appropriate in order to give notice to the persons with interest in the same trust indenture.**

53(4) **Subject to section 54(1), a court may order payment of all or a portion of the damages awarded to identified persons with interests in the same trust indenture at any time after judgment, and the obligation of the registrar to satisfy the judgment is satisfied to the extent that payment is so made.**

COMMENTARY

Section 53 applies in the event an action is brought against the registrar pursuant to section 52 by a trustee under a trust indenture or by a person with an interest in a trust indenture.

In order to avert multiplicity of litigation, section 53(1) requires that the action be a "class action" on behalf of all those interested in the indenture.

In order to forestall unnecessary problems of proof, section 53(2) makes it sufficient to show that the trustee relied on the search result in cases where the action is for loss or damage suffered as a result of reliance on a printed search result.. However, persons interested under the indenture are not entitled to recover damages if they actually knew that the search result was inaccurate at the time they acquired their interest.

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SECTION 54

PAYMENT OF CLAIM FOR LOSS

54(1) **The total amount recoverable in a single action under section 52, and the total amount recoverable for all claims in a single action under section 53 shall not exceed the amount prescribed.**

54(2) **Where damages are paid to a claimant pursuant to section 52 or 53, the Crown is subrogated to the rights of the claimant against any person indebted to the claimant whose debt to the claimant was the basis of the loss or damage in respect of which the claim was paid.**

54(3) **Where the claimant recovers pursuant to section 52 or 53 an amount less than the value of the interest the claimant would have had if the error or omission had not occurred, the right of subrogation under subsection (2) does not prejudice the right of the claimant to recover in priority to the Crown an amount equal to the difference between the amount paid to the claimant and the value of the interest the claimant would have had if the error or omission had not occurred.**

54(4) **The Comptroller may, without action being brought, pay the amount of a claim against the registrar when authorized to do so by the Minister responsible for this Act on the report of the registrar setting forth the facts and the opinion of the registrar that the claim is just and reasonable.**

54(5) **When an award of damages has been made in favour of a claimant and the time for appeal has expired, or when an appeal is taken and it is disposed of in whole or in part in favour of the claimant, the Comptroller shall authorize payment out of the Consolidated Fund of the Province, subject to subsection (1), the amount specified in the judgment in a manner specified in the judgment, including the costs of the claimant if the judgment so provides.**

COMMENTARY

Section 54(1) empowers the provincial cabinet to prescribe a maximum limit on the province's liability to pay a judgment awarded in an action against the registrar under sections 52 or 53. Similar limits have been prescribed in all PPSA jurisdictions. Ontario caps liability at $1,000,000 for claims under any single security agreement[1]. In Alberta, the maximum is currently $200,000 per single claimant and $2,000,000 in a class action by those interested under a trust indenture[2].

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[1] Ontario PPSA section 44(20)

Subsections 54(2) and (3) deal with the Crown's right of subrogation, on payment of damages, to the claimant's rights against the debtor whose debt was the basis of the loss or damage in respect of which the claim was paid.

Subsections 54(4) and (5) address the authority for and mechanics of payment of a claim out of the Consolidated Fund.

(continued)

[2] Alberta PPSA Regulations, section 55

PART 5
DEFAULT RIGHTS AND REMEDIES

SECTION 55

APPLICATION OF PART 5

55(1) This Part does not apply to

(a) a transaction referred to in section 3,

(b) a transaction between a pledgor and a pawnbroker.

55(2) In this section, "secured party" includes a receiver.

55(3) The rights and remedies referred to in this Part are cumulative.

55(4) Subject to any other Act or rule of law to the contrary, where the same obligation is secured by an interest in land and a security interest to which this Act applies, the secured party may

(a) proceed under this Part as to the personal property, or

(b) proceed as to both the land and the personal property in which case

(i) the secured party's rights, remedies and duties in respect of the land apply to the personal property with necessary modifications as if the personal property were land, and

(ii) this Part does not apply.

55(5) Subsection (4)(b) does not limit the rights of a secured party who has a interest in the personal property taken before or after the security interest mentioned in subsection (4), and the secured party

(a) has standing in proceedings taken in accordance with subsection (4)(b) and,

(b) may apply to the court for the conduct of a judicially supervised sale under subsection (4)(b) and the court may grant the application.

55(6) For the purpose of distribution of any proceeds from the sale of the land and personal property, the amount of the proceeds that is attributable to the sale of the personal property is in the proportion that the market value of the personal property at the time of the sale bears to the market value of the land and the personal property.

55(7) A security interest does not merge merely because a secured party has reduced the claim to judgment.

COMMENTARY

Purpose

Like Part 2, Part 5 of the PPSA focuses on the *inter partes* rights of the secured party and the debtor. But while Part 2 deals with their pre-default relationship, Part 5 codifies their rights and remedies in the unhappy event that it becomes necessary to realize on the security. Section 55 delineates the scope of application of the enforcement code established by Part 5.

Exclusion of Deemed Security Interests

Section 55(1)(a) confirms that Part 5 applies only to true security interests. This must be said because section 3 brings certain personal property transactions that do *not* secure payment or performance of an obligation within the scope of the Act: notably, commercial consignments, transfers of accounts and chattel paper and true leases for a term greater than one year. It is appropriate to deem these transactions to be security interests for the purposes of the conflicts, perfection and priority rules of the PPSA[1]. But it is neither appropriate nor practical to apply a remedial regime designed for debtor-creditor relationships to what are manifestly not debtor-creditor relationships.

Exclusion of Pledgor-Pawnbroker Transactions

Section 55(1)(b) excludes a transaction between a pledgor and a pawnbroker from the scope of Part 5. This does not mean that *all* persons who engage in the business of taking a pledge or pawn of personal property as security for a loan are relieved from compliance with Part 5. Section 55(1)(b) must be read in conjunction with the definition of "pawnbroker" in PPSA which restricts that status to creditors who take possession of consumer goods as collateral for an extension of credit for personal, family or household purposes. It was thought commercially preferable to leave the default aspects of these relatively informal 'small ticket' pawn transactions to be regulated outside the PPSA[2]. Subjecting them to the refined enforcement regime established by Part 5 might well cause a source of instant consumer credit to dry up.

Unlike the Western Model PPSA, the Ontario PPSA[3] excludes transactions with pawnbrokers from the scope of the PPSA generally and not just from Part 5. Moreover, the Ontario exclusion extends to all pawnbrokers as defined by the *Pawnbrokers Act*[4], *i.e.*, "a person who carries on the business of taking by way of pledge or pawn any article for the repayment of money lent thereon". At face value, the result is to remove all possessory security interests in "articles" from the reach of the PPSA. Assuming that the concept of "articles" is limited to goods and chattels, the Ontario exclusion still seems unjustifiably broad. Why establish detailed rules governing the conflict of laws, perfection and priority aspects of possessory security, as well as the rights of a secured party in possession of collateral prior to default, if all possessory security interests in as significant a type of collateral as goods are not going to be subject to those rules? And why should secured parties involved in commercial pledge transactions, as opposed to 'small ticket' consumer pawns, not be made subject even to Part 5?

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[1] See commentary on section 3.

[2] Unlike some of the other common law provinces (see, for instance, RSO 1980 c. 237, RSBC 1979, c. 314), New Brunswick does not have a *Pawnbrokers Act*. Statutory regulation of pawnbrokers in this province is limited to the licensing and record-keeping requirements imposed by the *Municipalities Act* (sections 165-167) and the *Salvage Dealers Licensing Act* (which brings licensed pawnbrokers within the definition of "salvage dealer"). Thus, the default aspects of the pledgor and pawnbroker relationship are largely regulated by the common law. For a recent critical discussion of the current limited regulation of the pawn in New Brunswick and in Canada generally, see Edward Veitch, "The Law o' the Brass Balls or the Regulation of the Pawn" (July 1991, publication forthcoming in the CBLJ).

[3] Section 4(1)(d)

Application to Receivers

In the commercial financing context, security is typically enforced through the appointment of a receiver who proceeds to realize on the collateral for the benefit of the secured party. Subsection (2) makes it clear that for the purposes of section 55, secured party includes a receiver[5] and a similar statement is found in the other PPSA sections relating to enforcement rights which are intended to extend to receivers.[6]

Rights and Remedies are Cumulative

At common law, mortgagees are entitled to pursue all their remedies at one and the same time[7]. Section 55(3) likewise makes it clear that the rights and remedies afforded by Part 5 are cumulative and that reliance on one does not preempt contemporaneous or subsequent reliance on another.

All rights and remedies provided by the PPSA must, however, be exercised in good faith and in a commercially reasonable manner.[8] Accordingly, the use of a combination of procedures aimed more at harassing the debtor than recovering overdue debt might well run afoul of this overriding duty.

No Merger of Security Interest in Judgment

Unlike their unsecured counterparts, secured creditors do not have to first sue for judgment before being entitled to exercise *real* rights against their debtors' assets. Indeed, this advantage is one of the principal reasons for taking security. But where the value of the collateral is clearly insufficient to satisfy the outstanding debt, a secured party will often want the status of a judgment creditor in order to be able to use execution remedies such as seizure and sale or garnishment to get at assets not subject to its security interest.

With the possible exception of conditional sales[9], existing law does not regard a secured party as having waived its right to realize against the collateral on the debtor's default merely because it also elects to sue for judgment in debt. So long as the judgment remains unsatisfied, the secured party retains its status and priority as such and may still revert to its right to take possession and dispose of the collateral *qua* secured creditor[10]. It is only where the secured party takes the judgment execution process to the stage of invoking a seizure *and* sale of the collateral by the sheriff that the doctrine of merger will operate to make the secured party's election unalterable[11]. In expressly providing that "a secured interest does not merge *merely* because a secured party has reduced the claim to judgment", section 55(7) codifies the existing law on this point. This policy is consistent with the general right of secured parties under section 55(3) to accumulate remedies.

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[4] RSO 1980 c. 137

[5] Note that "receiver" is defined in section 1 to include a receiver-manager,

[6] *i.e.*, sections 17, 36, 37, 38, 55, 56, 57, 58, 59(1), (2), (5), (14), (17), 60, 64, 66

[7] *Van Volkenburg v. Western Canadian Ranching Co.* (1895) 6 BCR 284 (SC), reversed on other grounds (1898) 6 BCR 296 (CA).

Enforcement of Security Agreements Covering both Real and Personal Property

The collateral covered by a commercial security agreement often comprises both real and personal property. In such cases, it may be impractical and inefficient for the secured party to adopt separate realization proceedings for the real property and the personal property. Accordingly, section 55(4) gives secured parties in this predicament an election. They may proceed against the personal property separately under Part 5. Or they may proceed cumulatively against both the real and personal property according to the rights and remedies applicable to real property security[12]. If they choose the latter course, Part 5 does not apply even with regard to the personal property.

However, an election to proceed under real property law releases the secured party from compliance with Part 5 only in respect of the debtor. Section 55(5) makes it clear that the election does not limit the rights of third parties with either a prior or subsequent security interest in the personal property. The secured party must, for instance, not only respect any priority rights they have in the collateral but also observe all notice requirements imposed by Part 5 for their benefit. To ensure that their interests are adequately respected and protected, section 55(5) gives them standing in any proceedings taken to enforce the security under real property law and entitles them to apply to the Court for the conduct of a judicially supervised sale.

Section 55(6) provides guidance on the inevitable valuation problems that will result in the event that personal property subject to third party security interests is disposed of to-

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(continued)

[8] See the commentary on section 65.

[9] In *Purth v. Henry* (1896) 33 NBR 607 (CA), it was held that a conditional vendor who sued the defaulting buyer to judgment for the purchase price was thereby deemed to have elected to treat the conditional sale as absolute and to have admitted that property had passed so that he could not thereafter maintain a suit for wrongful conversion *qua* owner against a purchaser without notice from the conditional buyer. Note also *John Deere Ltd. v. Remmen* [1972] 2 WWR 365 (Sask CA). However, the weight of jurisprudence is against merger: see *Wesbrook v. Willoughby* (1895) 10 Man R 690 (CA) which reached the opposite result to *Purth v Henry* on identical facts and see *Travis v. Way* (1901) 33 NSR 551 (CA); *Utterson Lumber Co, v. H.W. Petrie Ltd.* (1908) 17 OLR 570 (CA); *Morris v. McAulay* (1901) 21 CLT 547 (PEI TD).

[10] *Re Butler* (1964) 47 DLR (2d) 260 (Alta SC). Check also *West Coast Finance v. Peterson* (1965) 49 DLR (2d) 735 (BCSC) and *Dewar v. Bank of Montreal* (1984) 59 BCLR 167 (CA)

[11] *Trans Canada Credit Corporation Ltd. v. Foubert* (1960) 26 DLR (2d) 73 (Ont CA)

[12] *i.e.*, the *Property Act*, the *Judicature Act*, the *Registry Act*, the *Land Titles Act*, the *Rules of Court* relating to the enforcement of real property security, all as supplemented by the common law and equity.

gether with the real property by reason of an election under section 55(4)(b). A separate evaluation will be needed where the third party interest is subordinate to the interest of the secured party who has elected to enforce its security under real property law and the proceeds yielded by the disposal of both the real and personal property are in excess of the amount needed to satisfy the obligation owed to the enforcing creditor. It is necessary to know the value of the personal property collateral relative to the total collateral in order to determine what portion of the total surplus is payable to the subordinate third party interest. A separate evaluation will also be necessary if the third party security interest in the personal property has priority over the secured party with a security interest in both the real and the personal property. In such cases, the subordinate secured party has three options. She may (a) dispose of the debtor's interest in the collateral so that the purchaser would take subject to the third party security interest in the personal property; (b) pay out the third party security interest in advance so as to be in a position to give full title to a purchaser; (c) agree with the third party to dispose of the latter's interest in the personal property because a better price can be realized by disposing of the real and personal property together. If either the second or third option is chosen, it will be necessary to separately evaluate the personal property in order to know how much of the total proceeds is payable to the third party with the priority in the proceeds.

NOTES

SECTION 56

RIGHTS AND REMEDIES ON DEFAULT

56(1) **In this section, "secured party" includes a receiver.**

56(2) **Where the debtor is in default under a security agreement**

- **(a)** **except as provided by subsection (3), the secured party has against the debtor only**
  - **(i)** **the rights and remedies provided in the security agreement,**
  - **(ii)** **the rights, remedies and obligations provided in this Part and sections 36, 37 and 38, and**
  - **(iii)** **when in possession of the collateral, the rights, remedies and obligations provided in section 17,**
- **(b)** **the debtor has as against the secured party**
  - **(i)** **the rights and remedies provided in the security agreement,**
  - **(ii)** **the rights and remedies provided by any other Act or rule of law not inconsistent with this Act, and**
  - **(iii)** **the rights and remedies provided in this Part and in section 17.**

56(2) **Except as provided in sections 17, 59, 60 and 62, no provision of sections 17 or 58 to 63, to the extent that it gives rights to the debtor or imposes obligations on the secured party, can be waived or varied by agreement or otherwise.**

COMMENTARY

Sources of Parties' Default Rights and Remedies

Section 56 states the rights and remedies of the secured party and the debtor on default and specifies the extent to which these rights and remedies may be waived or varied by agreement of the parties.

Section 56(1) provides that upon default both the secured party and the debtor have the rights and remedies provided in Part 5. The rights and remedies provided in Part 5 vest in the parties automatically by virtue of their relationship and the fact of default whether or not expressly provided for in the security agreement. This is not to say that the parties may not agree to further or different rights and remedies. On the contrary, section 56(1) provides that the parties have, in addition to their Part 5 rights and remedies, the rights and remedies provided in the security agreement. However, the secured party is prohibited from contracting out of its Part 5 duties and obligations to the debtor. Section 56(2) states that no provision of sections 58 to 69 may be waived or varied by agreement or otherwise to the extent it gives rights to the debtor or imposes obligations on the secured party. Sections 58 to 69 encompass all of Part 5 (except for section 57 dealing with collection rights) as well as the two opening sections of Part 6, which preserve the supplementary application of the common law and equity, impose an overarching duty of good faith and commercial reasonableness in the exercise of rights and duties under the Act and prescribe damages for noncompliance with the *Act*.

The restrictions imposed by section 56 on freedom of contract in the default context reflect traditional legal policy. Both courts and legislatures have long found it necessary to fetter the secured party's ability to write its own default laws. The reasons are not hard to identify. Firstly, the imposition of mandatory enforcement procedures and standards is consistent with the common law's general insistence on adherence to "due process" when it comes to the involuntary alienation of property. Secondly, the ideal of perfect freedom of contract presumes a face to face dealing between two individual and roughly equal merchants. Where the dealing is between a collectivity of merchants with a monopoly on essential services and their hungry customers, legislatures have generally found it necessary to supplement the monopoly's standard form contract with a statutory one. Finally, legal regulation of the enforcement process is necessary to ensure adequate notice to and protection of third party interests in the collateral.

"Default"

The rights and remedies in Part 5 become operative only upon the debtor's default. The principal event of default is of course the debtor's failure to make timely payment of the secured obligation. This is reflected in part (a) of the definition of default in section 1 which defines default to mean "the failure to pay or otherwise perform the obligation secured when due".

Beyond default in payment, default events are a matter of negotiation between the parties. Security agreements typically define default events to include such as an unauthorized disposition or removal of the collateral, the apprehension of any other risk to the collateral, a sale in bulk or otherwise ceasing to carry on business, bankruptcy, insolvency, winding-up, the initiation of receivership or execution proceedings against the collateral by other creditors, a failure to pay debts to specified third parties when due and generally the debtor's failure to perform any duty under the security agreement. The freedom of the parties to define what are to be events of default beyond default in payment is expressly preserved by part (b) of the definition of default in section 1: "the occurrence of an event or set of circumstances that, under the terms of the security agreement, causes the security interest to become enforceable".

Insecurity Acceleration Clauses

Security agreements that provide for payments at fixed intervals generally include a so-called acceleration clause whereby on the happening of certain events, including the secured party feeling itself to be "insecure", the entire outstanding indebtedness becomes immediately due at the secured party's option. When payment is accelerated pursuant to such a clause, the debtor's failure to pay the entire secured debt will constitute default. For a discussion of the limits imposed by the PPSA on the secured party's exercise of acceleration powers pursuant to an insecurity clause, see the commentary on section 16. As to the debtor's right to reinstate the security agreement by paying only the installment in default notwithstanding the presence of an acceleration clause, see the commentary on section 62.

Default Remedies in the Existing Law and under the PPSA

Existing law recognizes four primary default remedies apart from an action on the underlying debt: possession, sale (with the right to claim any resulting deficiency), foreclosure, and the appointment of a receiver. In theory, the availability of these remedies varies with the type of security device involved. Foreclosure, for instance, was and technically remains the hallmark of the mortgage, since it is founded on the absolute transfer at law of full ownership in the collateral to the mortgagee. Accordingly, an equitable chargee, to whom is transferred neither the property nor a right to possession, has no right to foreclosure. To take another example, only the legal mortgagee and the pledgee enjoy an automatic implied right of possession and sale.

But with one exception, the general historical trend has been towards an assimilation of the rules governing the availability of these remedies and their mode of exercise, regardless of the class of security device involved. Assimilation has been accomplished mainly through commercial practice by the express inclusion in security agreements of appropriate remedial powers on default. A contractual right to possession and sale without judicial intervention is invariably included in every security agreement and will be respected by the courts. Even the remedy of foreclosure is now generally available since an equitable charge is generally drafted or will be interpreted to also take effect as an equitable mortgage upon default. Finally, receivership is available where appropriate either by court order or pursuant to an express power in the security agreement, a power that is invariably included in the case of commercial debtors.

The conditional sale stands out as the single exception to this process of assimilation. Of the four existing registration statutes, only the *Conditional Sales Act* also addresses enforcement. Legislative intervention was necessary for this form of security because of judicial reluctance to recognize a conditional sales contract as encompassing both a security interest and a sale of goods. The Act remedied this deficiency by recognizing an equity of redemption in the debtor and recognizing and regulating the seller's right to claim any deficiency after repossessing and selling the goods. But however necessary the legislative intervention, it put paid to any further assimilation of conditional sales default remedies with those available for other forms of security.

In providing a single uniform code to govern default rights and remedies, Part 5 gives legal sanction to commercial practice. The default remedies it provides to the secured party are the same four used in contemporary practice but with universal availability regardless of the type of security device and without the need for their express incorporation in the security agreement. The debtor's equity of redemption is likewise codified and expanded to include the additional right to cure a default and reinstate the security agreement notwithstanding the operation of any acceleration clause.

NOTES

SECTION 57

RIGHT TO COLLECT ON INTANGIBLES, CHATTEL PAPER AND INSTRUMENTS AND TO TAKE CONTROL OF PROCEEDS

57(1) **In this section, "secured party" includes a receiver.**

57(2) **Where the parties to a security agreement agree, and in any event on default under a security agreement, a secured party is entitled**

- **(a)** **to notify a debtor on an intangible or chattel paper or an obligor on an instrument to make payment to the secured party whether or not the assignor was making collections on the collateral before the notification, and**
- **(b)** **to take control of any proceeds to which the secured party is entitled under section 28, and**
- **(c)** **to apply any money taken as collateral to the satisfaction of the obligation secured by the security interest.**

57(3) **A secured party may deduct reasonable collection expenses**

- **(a)** **from amounts collected from a debtor on an intangible or chattel paper or from an obligor under an instrument, or**
- **(b)** **from money held as collateral.**

COMMENTARY

Collection Rights on Intangibles, Chattel Paper and Instruments

Section 57(2)(a) addresses the enforcement rights of the secured party where the collateral consists of money owed to the debtor by a third party. Collateral in this category may take the form of an intangible (such as a simple account receivable), chattel paper (such as a conditional sales contract) or an instrument (such as a promissory note).

Because these forms of collateral are the equivalent of cash, they are practically self-liquidating. In order to realize on the collateral, the secured party does not have to go through the two-step process of first seizing and then selling it. All that needs to be done to realize its value is to collect the money from the third parties who are obligated to the debtor. The risk of liability for a seizure in breach of the peace or a disposition at an undervalue is thus avoided. PPSA section 57(2)(a) confirms the existing practice and specifically empowers the secured party to notify a debtor on an intangible or chattel paper or an obligor on an instrument to make payment directly to the secured party.

When Collection Rights Arise

The pledge aside, security agreements normally preclude the secured party from assuming control of the collateral unless and until default has occurred. But where the collateral takes the form of money owed to the debtor, the financing arrangement may contemplate direct collection by the secured party from the outset. It is for this reason that section 57(2)(a) provides that the secured party's collection rights arise "where the security agreement so provides and in any event on default".

Right to Take Control of Proceeds

Under section 28, a security interest in collateral automatically extends to any proceeds stemming from a dealing in the collateral. Section 57(2)(b) ensures enforceability by expressly empowering secured parties to take control of any proceeds to which they are entitled under section 28.

How the secured party exercises this right to take control of proceeds will depend on the nature of the proceeds. Where they consist of an intangible, chattel paper or an instrument, the method will be direct collection pursuant to section 57(2)(a). For other forms of collateral, the secured party will have to look elsewhere in Part 5.

Right to Apply Money Collateral against Secured Debt and Right to Deduct Reasonable Collection Expenses

Existing law empowers a mortgagee to apply money received under the mortgage or from the proceeds of mortgaged securities in a like manner to money received as proceeds on a mortgage sale of unliquidated forms of collateral: *i.e.*, against the debt and interest secured by the mortgage and against the expenses incurred in collecting the money or securities and of conversion into money[1].

The PPSA essentially restates the existing law on this point. Section 57(2)(c) empowers the secured party to apply any money taken as collateral to the satisfaction of the obligation secured by the security interest. Section 57(3) authorizes the secured party to deduct reasonable collection expenses from money held as collateral or collected from the debtor's obligors pursuant to section 57(2)(a).

Comparison with Ontario PPSA

Section 61 of the new Ontario PPSA differs from section 57 of the Western Model, in several respects.

Firstly, the Ontario section talks about "a secured party who by agreement is entitled to charge back the collected collateral or otherwise to full or limited recourse against the debtor and who undertakes to collect from a person obligated on an account or on chattel paper or..on an instrument...". This wording is derived from UCC 9-502 and is also found in the Saskatchewan PPSA. However, it was dropped from the Western Model as unnecessary and potentially misleading. This is because the existence of a contractual right of recourse is significant only in situations where an assignment of accounts, chattel paper or instruments is not by way of security. Where the arrangement is a true security agreement, the secured party has an automatic right of recourse, i.e., a deficiency claim, against the debtor in the event that the collateral is of insufficient value to satisfy the secured obligation[2]. It is true that the PPSA applies to both types of assignments[3]. However, the application of Part 5 is restricted to true security interests[4].

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[1] *Property Act*, section 48(2)

Ontario section 61 and UCC 9-502 also require secured parties to proceed in a "commercially reasonable manner" in the exercise of their collection rights. The object is to protect the debtor against the risk of an increased deficiency liability or a reduced claim to any surplus should the secured party proves less than diligent in collecting from third parties. Under the Western Model, there is no need to say this in relation specifically to section 57. Section 65 imposes an overarching obligation on secured parties to act in good faith and in a commercially reasonable fashion in the exercise of *all* their rights and duties under the Act.

(continued)

[2] See the commentary to section 60.

[3] See the commentary to section 3.

[4] See the commentary to section 55.

NOTES

SECTION 58

RIGHT TO TAKE POSSESSION OF COLLATERAL AND OTHERWISE ENFORCE SECURITY AGREEMENT

58(1) **In this section, "secured party" includes a receiver.**

58(2) **Subject to sections 36, 37 and 38, on default under a security agreement**

(a) **the secured party has, unless otherwise agreed, the right to take possession of the collateral or otherwise enforce the security agreement by any method permitted by law,**

(b) **where the collateral is goods of a kind that cannot be readily moved from the debtor's premises or of a kind for which adequate storage facilities are not readily available, the secured party may seize or repossess the collateral without removing it from the debtor's premises in any manner by which a sheriff may seize without removal, if the secured party's interest is perfected by registration,**

(c) **where clause (b) applies, the secured party may dispose of collateral on the debtor's premises but shall not cause the person in possession of the premises any greater inconvenience and cost than is necessarily incidental to the disposal,**

(d) **if the collateral is a document of title, the secured party may proceed either as to the document of title or as to the goods covered by it, and a method of enforcement that is available with respect to the document of title is also available, with all necessary modifications, with respect to the goods covered by it.**

COMMENTARY

The Right to take Possession on Default

Under a pledge or pawn transaction, the secured party is in possession of the collateral from the outset. But if the security interest is nonpossessory - and most are - the secured party will need to take possession of the collateral on default as a preliminary step in the exercise of further remedies such as foreclosure or sale.

The security agreement will usually grant the secured party comprehensive powers in this regard. Apart from contract, the right to possession depends, under the existing law, on the nature of the security device. In the case of a legal mortgage, an implied right to possession follows the property[1]. But an equitable chargee *strictu senso*, in whom the property is not vested even in equity, must have either a contractual right or a judicial order. An equitable mortgagee may be in the same position. The conditional seller cannot repossess either in or out of court without an express contractual right[2].

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[1] Indeed, in the absence of an express redemise clause, the legal mortgagee's ownership

Under the PPSA, the accidental omission of a contractual right to take possession will no longer be potentially troublesome. Under section 58(2)(a), *all* secured parties have, *unless otherwise agreed*, the right on default to take possession of the collateral and otherwise enforce the security agreement by any method permitted by law. A statutory right to take possession, in other words, attaches automatically on default and the presence or absence of a contractual right is irrelevant except to the extent that it varies the statutory right[3].

The right to possession under section 58(2)(a) is expressly made subject to sections 36, 37 and 38 of the Act. These sections deal with security interests in fixtures, accessions and commingled goods. Owing to their attachment to other property, these types of collateral pose inherent complexities when it comes to obtaining possession and sections 36, 37 and 38 therefore prescribe special enforcement procedures.

Methods of Taking Possession

PPSA section 58(2)(a) authorizes the secured party to take possession "by any method permitted by law".

Where the collateral takes the form of money that is owed to the debtor by a third party, "taking possession" simply involves notifying the third party to pay the secured party directly pursuant to PPSA section 57.

The PPSA does not address specific methods for taking possession in relation to other forms of collateral. In many, if not most cases, the secured party will be able to persuade the debtor to relinquish possession voluntarily. Otherwise, one must look to the general methods for obtaining possession of personal property recognized by New Brunswick law. The two principal ones are: (1) common law self-help; (2) an application for an interim order for the recovery of personal property under Rule 44 of the *Rules of Court* (the statutory successor to the replevin action).

Of the two methods, self-help is obviously the cheaper, speedier and simpler. But if the secured party cannot take possession without provoking a breach of the peace, self-help brings in its wake the risk of tortious or even criminal liability[4].

(continued)
carries with it an implied right to take possession at any time, *i.e.*, even before default: see, for instance, *McAulay v. Allen* (1870) 20 UCCP 417 (Ont CA). But where the mortgage document contains terms empowering the secured party to seize and sell on default, the courts will readily imply a countervailing implied right in the mortgagor to retain possession until default: see, for instance, *Stevens v. Daly* (1902) 1 OWR 621 (CA)

[2] *Conditional Sales Act*, s. 15(1). See also *Humphrey Motors Ltd v. Ells* [1935] SCR 249.

[3] *Andrews v. Mack Finance (Canada) Ltd.* [1987] 46 DLR 4th 731 (Sask CA) at 738, overruling *Mid-Canada Radio Communications Ltd. v, Mechanical Services (1979) Ltd.* [1984] 25 BLR 187 (Sask QB) to the extent that case suggested that the secured party's statutory right of possession under the Saskatchewan PPSA was dependent on the existence of a contractual right.

[4] See, for instance, *Devoe v. Long* 26 MPR 357, [1951] 1 DLR 203 (NBCA) and *R. v. Doucette* [1960] OR 407, 33 CR 174, 25 DLR (2d) 380 (Ont CA). See generally D. Paciocco, "Personal Property Security Act Repossession: The Risk and the Remedy", in Debtor-Creditor Law: Practice and Doctrine, M. Springman and E. Gertner, eds., 1985, Ch. 8 at p. 365

Pre-PPSA Alberta law sought to preempt potential breaches of the peace in the exercise of common law self-help by requiring that all seizures to enforce security rights (other than seizures by a receiver) be made by a sheriff[5]. The same policy has been carried over in the Alberta PPSA[6]. But common law self-help has been left unaltered in the other Canadian common law provinces, both before and after the PPSA, and in the United States under the UCC.

On balance, it seemed best for New Brunswick to also preserve common law self-help as a method of taking possession. To *require* the agency of the sheriff in every case would add extra time and expense to the enforcement process. Absent evidence of wide-spread harassment or other unsavory behavior by secured parties, there is no justification for imposing a requirement that would only serve to further increase the *debtor's* borrowing costs. A secured party who fears a potential breach of the peace in effecting possession can always elect to have recovery effected by the sheriff pursuant to an order under Rule 44.

Taking Possession and Disposing of Goods to be Left on the Debtor's Premises

Taking possession of the collateral implies removing it from the debtor's to the secured party's premises or control. In general, this is something secured parties will wish to do in their own self-interest in any event. But physical removal may not always be practicable and the common law permits secured creditors to effect a constructive seizure *in situ*[7] by analogy to the equivalent right of sheriffs acting on behalf of execution creditors[8]. All that is needed is overt evidence of the requisite intention. The PPSA maintains and refines the common law policy in this regard. In cases where the collateral is goods of a kind that cannot be readily moved from the debtor's premises or for which adequate storage facilities are not readily available, section 58(2)(b) authorizes the secured party to seize or repossess the collateral without removing it from the debtor's premises in the same manner by which a sheriff may seize without removal. Under section 58(2)(c), the secured party is then entitled to dispose of the collateral on the premises provided this is accomplished at no greater inconvenience or expense than is necessarily incidental to the disposal. In order not to prejudice third parties who subsequently deal with the debtor, section 58(2)(b) makes perfection by registration a condition of effecting a constructive seizure.

Taking Possession where collateral is a document of title

Where the collateral is a document of title, the secured party may have to take possession of the goods covered by it from the bailee with whom they are lodged order to realize the value of the collateral[9]. Section 58(2)(c) therefore permits the secured party to proceed either as to the document of title or as to the goods and makes any method of enforcement that is available with respect to the document equally available with respect to the goods.

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[5] *Seizures Act*, RSA 1980 Chap S-11, s. 18

[6] Alta PPSA, ss. 58(2), 64.

[7] *Re Blackburn* [1925] 2 DLR 1206 (Ont SC)

[8] See, for instance, *Brooks v. Palmer* (1878) 17 NBR 615; compare *Reynolds v. Ayres* (1862) 10 NBR 333 (no overt act of seizure).

[9] See further the discussion on "documents of title" in the commentary to section 26.

Reasonable Notice Limitations on the Secured Party's Right to Enforce the Security Agreement on Default?

As soon as collateral is seized, whether directly or through an agent, employee or receiver, the debtor's credit reputation is put in question publicly and her ability to further finance irreparably impaired. Because there is generally no going back once enforcement is initiated, Canadian courts, in recent years, have revived and enlarged the historically-entrenched doctrine that secured parties who elect to enforce their security on default must first give the debtor reasonable notice of their intention in order to afford them a reasonable opportunity to pay[10]. Breach of this duty exposes the secured party to the risk of liability in damages for breach of contract, trespass and conversion.

The modern version of the reasonable time for payment doctrine was first revived in the context of receivership appointments under demand loans. However, courts in New Brunswick and elsewhere have since extended the doctrine to enforcement following default under a term or installment loan[11]. The emerging jurisprudence also makes it clear that a reasonable time for payment includes time to obtain refinancing and not simply time to get already available monies from some convenient place (albeit that in general the time required to be given will still be very short)[12]. Finally, the jurisprudence establishes that the reasonable time requirement is a rule of law and not construction and applies regardless of the wording of the security agreement[13].

Some commentators have argued that the reasonable time for payment doctrine conflicts with the language of the PPSA which assumes that the secured party's remedies under Part 5 arise "on default"[14]. Whatever the strength of this argument under the Ontario PPSA, the Western Model expressly provides that all rights and duties arising under the PPSA must be exercised in good faith and in a commercially reasonable manner. This provision probably suffices to bring the reasonable notice qualification into play as an overarching qualification on the right to take possession and enforce the security agreement under section 58.

Rights and Duties of Secured Party once in Possession

The rights and duties of a secured party in possession of collateral, whether before or after default, are the subject of PPSA section 17. For a detailed discussion, see the commentary to that section.

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[10] The seminal contemporary authority is *Ronald Elwyn Lister Ltd. v. Dunlop Canada Ltd.* (1982) 135 DLR (3d) 1, [1982] 1 SCR 726.

[11] *Roynat Ltd. v. Northern Meat Packers Ltd; Roynat v. Bourgoin* (1986) 29 DLR (4th) 139 (NBCA), leave to appeal to SCC refused 78 NBR (2d) 90

[12] *Kavcar Investments v. Aetna Financial Services ltd* (1989) 62 DLR (4th) 277 (Ont CA)

[13] *Kavcar Investments v. Aetna Financial Services ltd* (1989) 62 DLR (4th) 277 (Ont CA). On the values which support a restriction on the parties' contractual freedom in the enforcement context, see the commentary to section 56.

[14] Jacob Ziegel, "The Enforcement of Demand Debentures - Continuing Uncertainties" (1990) Can Bar Rev 718. As the title of his article suggests, Professor Ziegel is decidedly unsympathetic to a judicially-imposed reasonable notice rule. He argues for a detailed statutory solution that would establish a fixed period of time for payment.

SECTION 59

SECURED PARTY'S RIGHT TO DISPOSE OF COLLATERAL AFTER SEIZURE OR REPOSSESSION

59(1) **In subsections (2), (5), (13) and (16), "secured party" includes a receiver.**

59(2) **After seizing or repossessing the collateral, a secured party may dispose of it in its existing condition or after repair, processing or preparation for disposition, and the proceeds of the disposition shall be applied consecutively to**

(a) **the reasonable expenses of seizing, repossessing, holding, repairing, processing or preparing for disposition and disposing of the collateral and any other reasonable expenses incurred by the secured party, and**

(b) **the satisfaction of the obligations secured by the security interest of the party making the disposition,**

and any surplus shall be dealt with in accordance with section 60.

59(3) **Collateral may be disposed of**

(a) **by private sale,**

(b) **by public sale, including public auction or closed tender,**

(c) **as a whole or in commercial units or parts,**

(d) **if the security agreement so provides, by lease.**

59(4) **Where the security agreement so provides, the payment for the collateral being disposed of may be deferred.**

59(5) **The secured party may delay disposition of the collateral in whole or in part.**

59(6) **Not less than 20 days prior to disposition of the collateral, the secured party shall give a notice to**

(a) **the debtor or any other person who is known by the secured party to be an owner of the collateral,**

(b) **a creditor or person with a security interest in the collateral whose interest is subordinate to that of the secured party**

(i) **who has registered a financing statement according to the name of the debtor or according to the serial number of the collateral when it is required or permitted for registration, or**

(ii) whose security interest is perfected by possession at the time the secured party seized or repossessed the collateral, and

(c) any other person with an interest in the collateral who has given a written notice to the secured party of that person's interest in the collateral prior to the date that the notice of disposition is given to the debtor.

59(7) The notice referred to in subsection (6) shall contain

(a) a description of the collateral,

(b) the amount required to satisfy the obligation secured by the security interest,

(c) the sum actually in arrears, exclusive of the operation of an acceleration clause in the security agreement, and a brief description of any other default and the provision of the security agreement the breach of which resulted in the default,

(d) the amount of the applicable expenses referred to in subsection (2)(a) or, where the amount of the expenses has not been determined, a reasonable estimate,

(e) a statement that upon payment of the amount due under clauses (b) and (d), any person entitled to receive the notice may redeem the collateral,

(f) a statement that, on payment of the sums in arrears exclusive of the operation of any acceleration clause in the security agreement, or the curing of any other default, as the case may be, together with the amount due under subsection (2)(a), the debtor may reinstate the security agreement,

(g) a statement that unless the collateral is redeemed or the security agreement is reinstated, it will be disposed of and the debtor may be liable for a deficiency, and

(h) the date, time and place of any sale by public auction, or the place to which closed tenders may be delivered and the date after which closed tenders will not be accepted, or the date after which any private disposition of the collateral is to be made.

59(8) Where the notice required in subsection (6) is given to a person other than the debtor, it need not contain the information specified in subsections (7)(c), (f) and (g), and where the debtor is not entitled to reinstate the security agreement, the notice to the debtor need not contain the information specified in subsections (7)(c) and (f).

59(9) Not less than 20 days prior to the disposition of the collateral, a receiver shall give a notice to

(a) the debtor, and where the debtor is a corporation, a director of the corporation,

(b) any other person who is known by the secured party to be an owner of the collateral,

(c) a person referred to in subsection (6)(b), and

(d) any other person with an interest in the collateral who has given a notice to the receiver of the person's interest in the collateral before the day that notice of disposition is given to the debtor

59(10) The notice referred to in subsection (9) shall contain

(a) a description of the collateral,

(b) a statement that unless the collateral is redeemed it will be disposed of, and

(c) the date, time and place of any sale by public auction, or the place to which closed tenders may be delivered and the date after which closed tenders will not be accepted, or the date after which any private disposition of the collateral is to be made.

59(11) The notice required in subsection (6) or (9) may be given in accordance with section 69 or where it is to be given to a person who has registered a financing statement, by registered mail addressed to the person to whom it is to be given as it appears on the financing statement.

59(12) The secured party may purchase the collateral or any part of it only at a public sale as referred to in subsection (3)(b), and only for a price that bears a reasonable relationship to the market value of the collateral.

59(13) When a secured party disposes of collateral to a purchaser who acquires the interest for value and in good faith and who takes possession of it, the purchaser acquires the collateral free from

(a) the interest of the debtor,

(b) an interest subordinate to that of the debtor,

(c) an interest subordinate to that of the secured party,

whether or not the requirements of this section have been complied with by the secured party, and all obligations secured by the subordinate interests are deemed to be performed for the purposes of sections 49 and 50.

59(14) Subsection (13) does not apply so as to affect the rights of a person with a security interest deemed to be registered under section 73 who has not been given a notice under this section.

59(15) A person who is liable to a secured party under a guarantee, endorsement, covenant, repurchase agreement or the like and who receives a transfer of collateral from the secured party or who is subrogated to the rights of the secured party has thereafter the rights and duties of the secured party, and the transfer of collateral is not a disposition of the collateral.

59(16) The notice referred to in subsection (4) or (8) is not required where

(a) the collateral is perishable,

(b) the secured party believes on reasonable grounds that the collateral will decline

substantially in value if not disposed of immediately after default,

(c) the cost of care and storage of the collateral is disproportionately large relative to its value,

(d) the collateral is a security or instrument that is to be disposed of by sale on an organized market that handles large volumes of transactions between many different sellers and many different buyers,

(e) the collateral is money, other than a medium of exchange authorized by the Parliament of Canada, or

(f) for any other reason, a court on *ex parte* application is satisfied that a notice is not required,

(e) after default, each person entitled to receive a notice of disposition consents in writing to the disposition of the collateral without compliance with the notice requirements of sections (6) or (9).

COMMENTARY

The Secured Party's Power of Sale: Historical Background and Existing Law

Initially, strict foreclosure[1] was the mortgagee's sole default remedy whereas the holder of a pledge had a power of sale. Compared to strict foreclosure, sale presented three great advantages. Firstly, the remedy could be exercised out of court whereas foreclosure required a protracted court action. Secondly, the pledgor's right to redeem terminated on sale whereas the mortgagor's right to redeem could be reopened even after issuance of an absolute decree of foreclosure. Most significantly, the pledgee was entitled to claim the deficiency from the debtor in the event the proceeds of sale were insufficient to satisfy the debt and enforcement expenses whereas foreclosure extinguished the debtor's personal liability on the mortgage debt. True, the pledgee also remained under a duty to account for any surplus. However, deficiencies tended to be the rule and surpluses the exception especially in relation to security on personal property which, unlike real estate, tends to depreciate over time.

Mortgagees were quick to see the advantages of sale and from a very early period the ordinary mortgage document expressly provided for a contractual power of sale and right of deficiency. Commercial practice gradually evolved into commercial law and by the close of the nineteenth century, sale was widely accepted as an alternative to foreclosure even in the absence of an express contractual right[2]. A mortgagee in possession of personal property, it was said, could not be in a worse position than a pledgee. Only in the case of real estate mortgagees did the common law continue to require an express power of sale in the security agreement. However, under the New Brunswick *Property Act*, a statutory power of sale is implied into every mortgage made by deed whether on real or personal property[3]. Today, sale is the mortgagee's remedy of choice and foreclosure has virtually disappeared.

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[1] For a more detailed discussion of the secured party's foreclosure rights under pre-PPSA and PPSA law, see the commentary on section 61.

[2] *Re Morritt* (1886) 18 QBD 222; *Deverges v Sandeman, Clark & Co* [1902] 1 Ch 579, *Sawyer v Pringle* (1891) 18 OAR 218 affirming 20 OR 111; *Alice v Higgins* (1962) 33 DLR (2d) 63 (BCCA). An equitable chargee must, however, expressly reserve a power to appoint

Sale is also the conditional vendor's remedy of choice. However, here the security agreement must expressly reserve a right to repossess, sell and sue for a deficiency. Otherwise, the secured party's disposal of the collateral is seen as rescinding the contract of sale thereby extinguishing the debtor's obligation to pay the purchase price[4].

The Remedy of Sale under the PPSA

PPSA section 59 codifies and refines the secured party's right to dispose of the collateral after seizure or repossession while section 60 deals with the complementary right to claim a deficiency following disposition.

Under section 59, secured parties are given an automatic statutory right to dispose of the collateral following seizure or repossession. The right arises by operation of law and need not be expressly reserved in the security agreement (thought it invariably will be) regardless of the type of security interest.

The statutory right of disposition established by section 59 contemplates a cash sale. Under section 59(3)(d), the secured party may dispose of the collateral by lease only if the security agreement so permits and under section 59(4), payment may be deferred only if the security agreement so provides. Both qualifications reflect existing common law[5].

Secured Party's Duty on Sale

If the sale yields a surplus over the amount of the secured debt and enforcement expenses, the debtor is entitled to the difference. In the event of a deficiency, the debtor is liable to make good the difference. In view of the debtor's vital interest in the result of the sale, secured parties are subject to a well-established duty to act in good faith and to take reasonable precautions to obtain the best price possible for the collateral[6]. The secured party's common law responsibilities on sale are integrated into the PPSA by section 65 which requires that all duties, rights and obligations imposed by the Act be exercised in good faith and in a commercially reasonable manner.

In order to ensure that secured parties have the necessary flexibility to meet their duty on sale, section 59 gives them liberal discretion in choosing the method, venue, timing, and manner of sale.

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a receiver and sell the collateral out of court; otherwise, the only remedy is a court-ordered receivership and sale.

[3] Section 44(1)(a)

[4] For a more detailed discussion, see the commentary on section 60 which deals specifically with deficiency claims.

[5] At common law, in the absence of an express contractual right to sell on credit, a chattel mortgagee is not entitled to extend credit to the purchaser unless prepared to account to the mortgagor as though the sale had been on a cash receipt basis: see *Cruickshank v. Murphy Campbell Co.* (1958) 13 DLR 2d 250 (BCSC).

[6] *Rennie v. Block* (1896) 26 SCR 356. In New Brunswick, the leading modern case is *Canadian Imperial Bank of Commerce v. Haley* (1979) 25 NBR (2d) 304 (NBCA). For a recent confirmation of the New Brunswick law in this area, see *General Motors Acceptance Corporation of Canada v. Snowden and Lirette* (December 19, 1990, NBCA).

So, for instance, the collateral may sometimes realize a better price if it is first repaired or otherwise put in order for resale. In other cases, repair would not be economically worthwhile. Section 59(2) permits the secured party to elect, as circumstances dictate, between disposing of the collateral in its existing condition or after repair, processing or preparation for disposition.

The depreciation factor coupled with the expenses of holding mean that collateral should normally be sold as soon as practicable after seizure in order to realize the best price. But too hasty a liquidation is equally to be discouraged and market conditions may sometimes warrant a positive delay. In recognition of this, section 59(5) permits the secured party to delay disposition of the collateral in whole or in part.

The best venue for sale depends on the particular market for the particular type of collateral. The least desirable channel is the classic "liquidation sale" on the courthouse steps at which prospective purchasers fully expect to pay an undervalue. To encourage the use of more ordinary trade channels, existing law permits the secured party to sell the collateral either by private sale or public auction and either together or in lots[7]. The PPSA takes the same approach. The disposition must be by public sale only where there is self-dealing. Otherwise, under section 59(2), the disposition may be by private sale, by public auction or closed tender, as a whole, in commercial units or in parts. Such matters as the obtaining of appraisals and the manner and extent of advertising are likewise left to the secured party to decide as best compatible with the duty to take reasonable precautions to obtain the best price.

Secured Party's Right to "Buy in" at the Sale

At common law, a mortgagee who bids and buys at its own sale is treated as having taken the goods in full satisfaction of the secured debt and cannot afterwards claim against the mortgagor for any deficiency[8]. A similar rule applies in the conditional sales context[9]. The explanation for the rule is the natural fear that the secured party would purchase at an undervalue, resell forthwith for the true value yet charge the debtor with the deficiency on the first sale.

The common law prohibition on self-dealing has been modified by statute in most North American jurisdictions, including New Brunswick. Under the *Property Act*[10], mortgagees may buy in at their own sales provided the purchase is "at auction".

The PPSA maintains the *Property Act* policy. Section 59(12) permits the secured party to purchase the collateral or any part of it at a public sale.

The public sale requirement alone does not offer sufficient assurance against the common law's concern with ensuring a fair price on a self-dealing. The expectation underlying the requirement is that an adequately publicized sale, to which the public is invited and entitled to attend, will produce competitive bids so as to drive the price up to something approximating fair market value. But what if the collateral is of a type that could more lucratively be disposed of through private channels? Presumably, the self-dealing secured party by choosing the public sale venue would then be in breach of the duty to exercise reasonable precautions to secure the best possible purchase price for the collateral. This is confirmed by section 59(12) which stipulates that the secured party may buy in "only for a price that bears a reasonable relationship to the market value of the collateral".

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[7] *Property Act* c. P-19, section 44(1)(a); *Conditional Sales Act*, c. C-15, section 15(3)

[8] *Wood v. Detlor* (1909) 14 OWR 192 (HC); *McCormick v. Haworth* [1929] 2 DLR 835 (Sask CA); *Gladman v. Hothersall* [1936] OWN 358 (HC)

[9] *McCormick v. Haworth* [1929] 2 DLR 835 (Sask CA); *Soice v. Haffner* [1927] 2 DLR 1148 (Alta TD); *Gray-Campbell Co. v. Morrison* [1924] 2 DLR 487 (CA). *Cf. Minneapolis Steel & Machinery Co. v. Paulerrou (No. 2)* [1928] 1 WWR 976 (Alta TD) where it was held that the court could give leave to the seller to bid at its own sale.

[10] Section 44(1)(a)

Application of Proceeds of Disposition

Under existing law, a mortgagee is entitled to deduct all reasonable expenses of realization of the collateral from the proceeds of sale on the theory that unless this is done the sale price does not represent the true value of the collateral[11]. Under the *Property Act*, the proceeds of sale are therefore applied firstly against proper enforcement expenses and secondly against the secured debt[12].

The PPSA restates the same basic policy in comprehensive terms.

Under section 59(2)(a), the proceeds of sale are to be applied firstly to satisfaction of the reasonable enforcement expenses incurred by the secured party; specifically, the reasonable expenses of seizing, repossessing, holding and disposing of the collateral (and any other reasonable expenses including, if applicable, repairing, processing or otherwise preparing the collateral for distribution).

Under section 59(2)(b) the residue of the proceeds is then applied to the satisfaction of the obligations secured by the security interest of the party making the disposition. The "obligations secured" naturally will include the original debt and any further advances made during the currency of the financing arrangement along with the contractual interest charges. To this will be added, pursuant to section 17(3)((a), the secured party's reasonable expenses, including insurance and taxes, incurred in obtaining, maintaining possession of and preserving the collateral. Under section 17(3)(a), such expenses are secured by the collateral whether possession was taken before default for the purposes of perfection or after default for the purposes of enforcement. In the case of post-default expenses, however, there may be some overlap with the expenses listed in section 59(2)(a). Finally, other expenses incurred by the secured party during the financing arrangement to protect its security interest may form part of the secured obligation under the terms of the security agreement.

Any remaining surplus must then be dealt with in accordance with section 60.

Notice of Sale: To whom must notice be given?

Section 59(6) addresses the advance notification obligations of the secured party in relation to the disposition of the collateral while section 59(9) deals with the same issue in the receivership context. This is an area on which the existing law is less than satisfactory and on which section 59 gives welcome and plentiful guidance.

Under section 59(6), the secured party is required to give the debtor a minimum of 20 days advance notice of a proposed disposition. In the event the disposition is by a receiver and the debtor is a corporation, notice must also be given to a director of the corporation: section 59(9)(a).

Advance notice is necessary to give meaning to the debtor's right under section 62 to redeem the collateral or reinstate the security agreement before disposition. Even if redemption or reinstatement is not practical, advance notice will at least enable the debtor to alert possible purchasers and otherwise monitor the secured party's conduct of the sale so as to ensure the best possible yield.

The debtor *strictu sensu* may not be the only person vitally interested in the proceeds realized by the sale. A guarantor, for instance, has an equal or greater interest in keeping the deficiency as low as possible. PPSA section 1 defines "debtor" in comprehensive terms to include, *inter alia*, any person who owes payment or performance of the secured obligation regardless of whether that person owns or has rights in the collateral. Thus guarantors and others falling within the statutory definition will equally be entitled to advance notice of the sale under section 59(6) and 59(9).

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[11] *McHugh v. Union Bank* (1913) 10 DLR 562 (JCPC) at 570

[12] *Property Act*, section 47(3)(a). *Cf.* the *Conditional Sales Act*, section 15(4)(b) which

Apart from the "debtor" as defined in section 1, sections 59(6) and 59(9) require that advance notice be sent to three other classes of persons with an interest in the collateral. Their interest in the collateral gives them an equal right with the debtor to redeem the collateral prior to disposition (see section 63) as well as a claim to any surplus proceeds yielded by the sale (see section 60). They are thus entitled to advance notice of a proposed disposition for the same reasons the debtor is: to enable them to decide whether to exercise their redemption rights under section 62 and to monitor the sale process so as to ensure the highest possible return.

The first class is "any other person who is known by the secured party to be an owner of the collateral": section 59(6)(a) and 59(10)(b). (As to what constitutes knowledge, see section 1(2)).

The second class comprises subordinate creditors who have registered a financing statement against the debtor or against the collateral by serial number or whose security interest was perfected by possession when the secured party took possession of the collateral: sections 59(6)(b) and 59(10)(c). This class includes subordinate secured *and* unsecured creditors if the latter have registered a judgment in the PPSA registry (see section 20).

The third class comprises any other person with an interest in the collateral (for instance, a subordinate secured party without a registered financing statement or an unsecured creditor who has delivered an order for seizure and sale to the sheriff) who has given a written notice to the secured party (or receiver) of that interest prior to the date that notice of disposition is given to the debtor.

Notice of Sale: Requisite Contents

Under sections 59(7) and 59(8), the secured party's notice of sale must minimally describe the collateral, state the amounts of the secured debt and expenses that are outstanding, refer to the recipient's right of redemption and give the time and venue of a public sale or the date after which a private disposition may be made, as the case may be. The notice to the debtor must also refer to the debtor's potential liability for a deficiency. So long as the debtor still has the right to reinstate the security agreement, the notice must also refer to that right and state the sum actually in arrears that must be paid and describe any other event of default which must be cured in order to reinstate.

Considerably less detailed information is needed when the notification of sale is sent by a receiver rather than the secured party. Under section 59(10), the notice need only give a description of the collateral, state that unless the collateral is redeemed it will be disposed of, and give the time and venue for a sale by public auction or closed tender or the date after which a private disposition is to be made, as the case may be.

Notice of Sale: When dispensed with

At present, under the *Conditional Sales Act*, the statutory notice of sale requirements apply "notwithstanding any agreement to the contrary". Although the section prevents a waiver of the statutory requirements in the original security agreement, a post-default waiver is perfectly permissible[13] since at this stage any waiver is by definition an informed one.

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does not state the order of application.

The PPSA takes the same approach. Under section 59(16), notice of sale is not required where all persons entitled to notice of disposition execute a post-default waiver of their right.

Section 59(16) also authorizes the secured party to unilaterally dispense with the notice requirements where authorized by a court on an *ex parte* application or where notice is either unnecessary or potentially prejudicial to the interests of both parties.

Notice is unnecessary where the reasons for the requirement are absent. This will be the case if two conditions are met. Firstly, the collateral is of a generic readily replaceable type so that redemption is not critical. Secondly, the value of the proceeds is established by market forces which operate independently of the seller's conduct on disposition so that there is no need to ensure that the sales process is conducted so as to ensure the best yield. It is because these conditions are present that section 59(16) also dispenses with the notification requirement if the collateral is money other than a medium of exchange authorized by the Parliament of Canada or a security or instrument that is disposed of by sale on an organized market that handles large volumes of transactions between many different sellers and many different buyers.

The notice requirement is prejudicial to the interests of both parties if any delay in disposition is apt to increase the deficiency liability or decrease the surplus after sale, as the case may be. Thus section 59(16) dispenses with notice where the collateral is perishable or the cost of its care and storage is disproportionately large relative to its value or if the secured party believes on reasonable grounds that if the collateral is not disposed of immediately after default, it will decline substantially in value.

Purchaser's Title on Sale

Under the existing law, a *bona fide* purchaser at a mortgage sale acquires title to the collateral free and clear of the mortgagor's and all other subordinate interests[14]. Their remedy after sale is a claim against any surplus proceeds in the hands of the mortgagee[15]. The purchaser's title is not impeachable even if due notice was not given or the sale was unauthorized or otherwise improperly or irregularly conducted[16]. A court will move to set aside the sale only if evidence of fraud or irregularity is brought home to the purchaser[17]. otherwise, the only remedy is an action for damages against the mortgagee[18].

The existing law on this point makes economic good sense. If title were liable to be set aside on account of matters of which the purchaser was ignorant, the value of the collateral on forced sales would be diminished to the detriment of both debtor and secured party.

PPSA section 59(13) restates the existing law: the purchaser takes free of the interest of the debtor and of any interests subordinate to the debtor or the secured party so long as the collateral was acquired for value and in good faith and the purchaser takes possession.

Under existing law, a mortgagee is not barred from exercising the remedy of sale just because there are others with superior *real* rights in the collateral. However, the purchaser

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[13] *Thomas Brooks & Son v. Drury* [1927] 2 DLR 399 (Ont CA)

[14] *Property Act*, section 47(1)

[15] See further the commentary on section 60.

[16] *Property Act*, section 47(2)

[17] R.M. Willes Chitty, *Barron and O'Brien on Chattel Mortgages and Bills of Sale*, 3d ed., Canada Law Book (Toronto, 1927), at 100 and 103. The same rule has also been accepted in the context of a resale without notice by a conditional vendor: *R.A. Carbol Trailways v. Industrial Acceptance Corporation* (1972) 32 DLR 3d 89 (Alta CA). *Cf. Huether v. Waldsmidt* (1922) 23 OWN 76 (HC).

[18] *Property Act*, section 47(2).

takes the collateral subject to all estates, interests and rights that have priority to the mortgage unless they consent to the sale and to be paid out of the purchase money[19]. The title protection that PPSA section 59(13) affords to purchasers from the secured party is likewise limited to protection against subordinate interests.

Disposition of Collateral by Receivers

Section 59(1) defines "secured party" to include a receiver for the purposes of subsections (2), (5) (13) and (16). In addition, subsections (9) and (10) prescribe special notice requirements where the disposition is by a receiver rather than a secured party *strictu senso*.

Consequences of a failure to give notice or other non compliance with the duty on sale

See the commentary on section 66 for a discussion of the debtor's remedy in damages against the secured party for a failure to conduct the disposition in accordance with the requirements of section 59 and the impact this may have on the secured party's deficiency claim.

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[19] *Property Act*, section 47(1); and at common law, see, for instance *Wallace v. Smart* (1912) 1 DLR 70 (Man KB) at 74.

SECTION 60

SURPLUS OR DEFICIENCY AFTER DISPOSAL

60(1) In this section "secured party" includes a receiver.

60(2) Where a security agreement secures an indebtedness and the secured party has dealt with the collateral under section 57, or has disposed of it in accordance with section 59 or otherwise, any surplus shall, unless otherwise provided by law or by the agreement of all interested parties, be accounted for and paid in the following order to

(a) a person who has a subordinate security interest in the collateral

(i) who registers, before the distribution of the proceeds, a financing statement using the name of the debtor or according to the serial number of the collateral if the goods are defined in the regulations as serial numbered goods, or

(ii) whose interest was perfected by possession at the time the collateral was seized,

(b) any other person with an interest in the surplus, if that person has given a written notice thereof to the secured party prior to the distribution, and

(c) the debtor or any other person who is known by the secured party to be an owner of the collateral,

but the priority of claim of any person referred to in (a), (b) or (c) is not prejudiced by payment to anyone pursuant to this section.

60(3) The secured party shall give a written accounting of

(a) the amount received from the disposition of collateral or the amount collected under section 57,

(b) the manner in which the collateral was disposed of,

(c) the amount of expenses as provided in sections 17, 57 and 59,

(d) the distribution of the amount received from the disposition or collection, and

(e) the amount of any surplus,

to a person referred to in subsection (2) within 30 days after receipt of a written request for an accounting.

60(4) Where there is a question as to who is entitled to receive payment under subsection (2),

the secured party may pay the surplus into court and the surplus shall not be paid out except upon an application under section 67 by a person claiming an entitlement to it.

60(5) **Unless otherwise agreed, or unless otherwise provided in this or any other Act, the debtor is liable to pay to the secured party the deficiency.**

COMMENTARY

Purpose

The term "collateral" accurately reflects the qualified nature of the secured party's interest in the charged assets; *i.e.*, it is collateral to the debt which remains the primary obligation. It follows that if the proceeds realized from the collateral under sections 57 or 59 are less than what is needed to satisfy the expenses, debt and interest, the debtor remains liable for the deficiency; conversely, any surplus cannot be retained by the secured party but must be paid over to the holder(s) of the residual interest in the collateral.

Section 60 confirms the debtor's liability for a deficiency and specifies the order of payment of any surplus. The section also deals with two related issues: the secured party's duty to account for proceeds and its interpleader rights in the event of conflicting claims to the surplus.

The Debtor's Liability for a Deficiency: Existing Law

At common law, a mortgagee is entitled to sue for any deficiency after applying the proceeds realized from the collateral to the debt, interest and expenses. The right to a deficiency arises by implication of law from the debtor's covenant to pay the mortgage debt; there is no need to include an additional deficiency covenant in the security agreement[1].

The conditional sale is a different story. At first, Canadian courts were willing to analogize the conditional seller's repossession and resale of the collateral to the mortgagee's remedy of seizure and sale. But the early cases arose in the context of the *buyer's* right to a surplus following the buyer's repossession and resale[2], a right to which they were clearly sympathetic. When the jurisprudential focus shifted to the *seller's* right to claim a deficiency following resale, the theory also shifted. Now the conditional sale was to be treated as no different than the absolute sale[3]. It followed that the seller's resale rescinded the contract because it put it out of the seller's power to perform her primary obligation to convey ownership and possession of the subject chattels. The contract having been rescinded, the buyer was likewise released from her primary obligation to pay the balance of the purchase price. The result was that if the conditional seller wanted a deficiency claim after resale, she would have to stipulate for it in the security agreement. The courts would not cooperate by implying one *ex post facto*[4]. While the conditional seller's deficiency rights are now regulated by the *Conditional Sales Act*, the *Act* likewise recognizes a deficiency right only if the conditional sales contract expressly provides for one[5] (and then only if the seller complies strictly with the statutory notice and other requirements governing resale[6]).

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[1] *Acadia Loans Co. v. Legere* 45 NSR 328; *Alice v Higgins* (1962) 33 DLR 2d 63 (BCCA)

[2] *C.C. Motor Sales Ltd. v. Chan* [1926] SCR 485

[3] On the effect of a resale in the absolute sale context, see *R.V. Ward Ltd. v. Bignall* [1967] 2 ALL ER 449 (English CA).

[4] *Sawyer v. Pringle* (1891) 18 OAR 218, *Humprhrey Motors Ltd. v. Ells* [1935] SCR

We can surmise that the common law's strict and *sui generis* treatment of deficiency claims by conditional vendors was motivated by sympathy for the consumer retail buyer. But if there are policy justifications for outlawing deficiency claims in the consumer or any other context, explicit anti-deficiency laws should be enacted directly (as a number of provinces have done). Manipulating general doctrine so as to deny the security aspect of conditional sales transactions is a crude and ultimately ineffective means to that end.

The Debtor's Liability for a Deficiency under the PPSA

The original Ontario PPSA did not give secured parties an automatic statutory right to claim a deficiency. Instead, it simply regulated the exercise of whatever deficiency right they might otherwise have at common law or under the security agreement. This apparently inadvertent omission has equally inadvertent consequences. The old conditional sales jurisprudence was carried over to the Ontario PPSA context with the result that a conditional vendor who failed to expressly reserve a deficiency claim in the security agreement could not rely on the law to supply one[7].

The Saskatchewan PPSA repairs the Ontario omission and provides for an automatic statutory deficiency right. Section 60(3) states unequivocally that the "unless otherwise agreed in the security agreement, or unless otherwise provided under this or any other Act, the debtor is liable for any deficiency". The reference to the possibility of contrary provision in the PPSA or another Act contemplates the continued application of the problem-specific anti-deficiency legislation that has long been part of the Saskatchewan legal landscape.

The Saskatchewan wording has been carried over to both the Western Model and the new Ontario PPSA and appears as section 60(5) of the proposed New Brunswick Act. Under the new versions, the pre-PPSA conditional sales jurisprudence is no longer relevant.

(continued)
249

[5] *CSA*, section 15. And see *Humphrey v. Ells* [1935] SCR 249 affirming [1934] 3 DLR 140 (NBCA).

[6] The impact of a failure to give adequate notice of sale or other irregularity on the secured party's right to a deficiency is discussed in the commentary to section 66.

[7] *G.O. Hill Supply Ltd. v. Little Norway etc. Ltd.* (1980) 1 PPSAC 190 (Ont CA); *Ford Motor Company v. Preuschoff et al* (1983) 2 PPSAC 279 (Ont Cty Ct). Both these cases dealt with the deficiency rights of conditional vendors. However, in *Royal Bank v. Segreto Construction Ltd.* (1988) 8 PPSAC 43 (Ont CA), Finlayson JA mistakenly extrapolated, from the peculiar exception of the conditional sale, a general pre-*PPSA* rule that in the absence of an express covenant by the debtor "there was no right at common law to sue for deficiencies" (p.49). On this view, *all* secured parties, not just conditional vendors, would have been denied a deficiency claim in the absence of an express contractual right. However, in its subsequent *per curiam* decision in *Bank of Montreal v. Featherstone* (1989) 9 PPSAC 139 (Ont CA), the Court corrected the error. While finding it unnecessary on the facts to pursue the issue, the Court noted that "at common law it was only in the case of a conditional sale that the creditor in the absence of an express agreement to the contrary was not entitled to recover any deficiency" (p. 143).

Distribution of Surplus Proceeds

Under existing law, a mortgagee who realizes on collateral cannot retain any surplus remaining after the enforcement expenses have been paid and the debt and interest discharged. The *Property Act* requires that the surplus be paid "to the person entitled to the mortgaged property"[8]. According to the caselaw, payment should be made firstly to subordinate mortgagees and other encumbrancers in order of priority with the balance if any going to the mortgagor[9].

Subordinate interests, including execution creditors, are entitled to a remedy against the surplus because realization terminates their rights against the collateral even where the disposition was irregularly conducted[10]. This is also the case under the PPSA[11]. Accordingly, PPSA section 60(2) requires the secured party to account for and pay over any surplus firstly to the holders of any subordinate security interests in the same collateral and secondly to any other person with an interest in the surplus. The balance if any must be paid to the debtor except where the secured party knows that the collateral is owned by somebody other than the debtor. In that event, the residue goes to the owner and not the debtor[12].

At common law, notice of a claim to surplus proceeds must be given to the mortgagee or it must have notice of the encumbrances on which such claims may be founded. Otherwise, the mortgagee will not be responsible if it pays the surplus to the apparent owner of the equity of redemption[13].

The PPSA likewise protects secured parties against liability for failing to apply surplus proceeds in payment of claims of which they had no knowledge or means of acquiring knowledge. Under section 60(2)(b), claimants must give written notice of their interest to the secured party prior to distribution to be entitled to share in the surplus. Under section 60(2)(a), written notice is not required if the claim is based on a subordinate security interest in the collateral that was either perfected by possession at the time the goods were seized or perfected by registration according to the debtor's name (or the serial number of the collateral if applicable) prior to the distribution of the proceeds. Notice is not required in these two instances because the secured party will *ipso facto* know of the existence of any security interest that was perfected by possession at the time of seizure and will have the means of finding out about a security interest that was perfected by registration simply by searching the Registry prior to distribution.

Section 60(2) refers only to the rights of *subordinate* interests in the collateral to share in surplus proceeds. *Senior* secured parties are not entitled to any claim in the proceeds because the disposition only terminates interests in the collateral that are *subordinate* to the interest of the enforcing creditor[14]. Since the purchaser takes title subject to the interests of the *senior* secured parties, their remedy remains in the collateral rather than the proceeds of disposition. The existing law on this point is likewise and in a case where a fourth mortgagee sold collateral without the consent or participation of the prior mortgagees but then applied the surplus proceeds to pay them off, he was held liable to account to the mortgagor for the surplus over and above his own mortgage debt and costs[15].

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[8] *Property Act*, section 47(3)

[9] *Canadian Car Co. Ltd. v. Pelletier* (1961) 50 MPR 272 (NBSC Ch Div)

[10] *Ibid*

[11] See the commentary accompanying section 59.

[12] There is nothing to prevent the owner from giving a security interest in an asset to secure another's debt. If this is done, the equity of redemption will vest in the owner and not the debtor. See *Re Dominion Shipbuilding & Repair Co.* (1923) 53 OLR 485 (HC)

[13] *Harper v. Culbert et al* (1883) 5 OR 152 (Ch Div) especially at 162.

[14] See the commentary on section 59.

Priority Disputes over Surplus Proceeds

The order of payment outlined in section 60(2) is based on the *prima facie* order of priority of the possible subordinate interests in the collateral. However, there may well be cases where the "other person with an interest in the collateral" referred to in paragraph (b) has priority over the "person with a security interest in the collateral" referred to in (a). Section 60(2) is intended to give secured parties guidance on their distribution obligation, not to alter substantive priority rights among the competing claimants. To avoid any argument *contra*, section 60(2) concludes with the proviso that the priority of claim of any person referred to in (a), (b) or (c) is not prejudiced by payment to anyone pursuant to the section.

Payment in accordance with section 60(2) will protect the secured party from liability where the order of payment established by the section does not reflect the true order of priority. But if any question arises as to who is entitled to the surplus before distribution takes place, the secured party should be able to simply pay it into court and let the competing claimants sort out their differences among themselves. Section 60(4) maintains the common law[16] on this point and entitles the secured party to do exactly that.

Duty to Account

Where a secured party has disposed of collateral under section 59 or exercised its collection rights under section 57, those with an interest in any surplus should obviously be entitled to find out the basic financial and logistical details. Section 60(4) codifies the secured party's duty in this regard and places a time limit on when it must be met. Within 30 days after receipt of a written request for an accounting, the secured party must disclose the amount of the proceeds received from the disposition or collection, their distribution, the amount charged to expenses, the amount of any surplus and the manner of disposition of the collateral.

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[15] *Drost v. Dey* (1960) 20 DLR (2d) 88 (NBCA)
[16] *Boyne v. Robinson* (1904) 3 NB Eq 57

NOTES

SECTION 61

RETENTION OF COLLATERAL IN SATISFACTION OF OBLIGATION ('STRICT FORECLOSURE')

61(1) After default, the secured party may propose to take the collateral in satisfaction of the obligation secured by it, and shall give notice of the proposal to

(a) the debtor or any other person who is known by the secured party to be an owner of the collateral,

(b) a creditor or person with a security interest in the collateral whose interest is subordinate to that of the secured party

(i) who has registered a financing statement using the name of the debtor or according to the serial number of the collateral when it is required or permitted for registration, or

(ii) whose security interest is perfected by possession at the time the secured party seized or repossessed the collateral, and

(c) any other person with an interest in the collateral who has given a written notice of that interest to the secured party prior to the date that the notice is given to the debtor.

61(2) If any person is entitled to a notice under subsection (1) and whose interest in the collateral would be adversely affected by the secured party's proposal gives to the secured party a notice of objection within 15 days after the notice under subsection (1), the secured party shall dispose of the collateral under section 59.

61(3) If no notice of objection is given, the secured party is, at the expiration of the 15 day period or periods referred to in subsection (2), deemed to have irrevocably elected to take the collateral in satisfaction of the obligation secured by it, and is entitled to hold or dispose of the collateral free from all rights and interests of the debtor and any person entitled to receive a notice under

(a) subsection (1)(b), and

(b) subsection 1(c),

who has been given the notice and all obligations secured by such interests are deemed performed for the purposes of sections 49 and 50.

61(4) The notice required under subsection (1) may be given in accordance with section 69 or, if it is to be given to a person who has registered a financing statement, by registered mail addressed to the address of the person to whom it is to be given as it appears on the financing statement.

61(5) The secured party may request that any person referred to in subsection (1), other than the debtor, furnish proof of that person's interest and, unless the person furnishes proof not later than 10 days after the secured party's request, the secured party may proceed as if no objection were received from the person.

61(6) Upon application by a secured party, a court may determine that an objection to the proposal of a secured party is ineffective on the ground that

(a) the person made the objection for a purpose other than the protection of an interest in the collateral or proceeds of a disposition of the collateral, or

(b) the market value of the collateral is less than the total amount owing to the secured party and the costs of disposition.

61(7) Where a secured party disposes of the collateral to a purchaser for value and in good faith and who takes possession of it, the purchaser acquires the collateral free from

(a) the interest of the debtor,

(b) any interest subordinate to that of the debtor,

(c) any interest subordinate to that of the secured party,

whether or not the requirements of this section have been complied with by the secured party, and all obligations secured by the subordinate interest are deemed to be performed for the purposes of section 49 and 50.

61(8) Subsection (7) does not apply so as to affect the rights of a person with a security interest deemed to be registered under section 73 who has not received a notice under this section.

COMMENTARY

Historical Background and Existing Law

'Strict foreclosure', the mortgagee's classic remedy, involves a pure exchange of the collateral for the debt. Its conceptual origins lie in the form of the mortgage document - an absolute transfer of full ownership in the collateral subject to a defeaseance or proviso for redemption if the loan is repaid when due. The remedy in effect follows from the form of the transaction as one of absolute sale rather than security. This explains why foreclosure is not available to enforce either a pledge or an equitable charge *strictu senso*. Both these devices are patently pure security transactions. Consequently, there is no conveyance of absolute ownership either at law or in equity. Rather, the secured party's interest in the collateral is limited to and defined by whatever *real* rights are necessary to enable these devices to perform their security function: in the case of the pledge, a "special property", essentially a power to sell the collateral on default and retain only so much of the proceeds as is necessary to discharge the debt and expenses; in the case of the equitable charge, a right to apply to a court for whatever remedies are necessary to likewise realize the value of the collateral.

Like the mortgagee, the conditional seller also holds full ownership in the collateral.

Consequently, it too may elect to simply take its property in substitution for the debt on default.

However, in the case of a mortgage, equity prevents the mortgagee from simply asserting its strict contractual ownership rights upon the mortgagor's default. The mortgagor and any subordinate encumbrancers may still apply to redeem the collateral. In order to cut off their equity of redemption, the mortgagee must apply to court for a decree of foreclosure requiring them to redeem within some set period or face forfeiture of their rights in the collateral.

The conditional seller does not have to go to court in order to foreclose the buyer's rights in the collateral after default. Title under a conditional sale originates with and is retained by the secured party rather than being transferred by the debtor subject to a defeasance as under a mortgage. Consequently, *de facto* foreclosure may be initiated simply by the conditional seller exercising its contractual right to retake possession of the collateral on default. True, the *Conditional Sales Act* gives the buyer a statutory right to redeem for a twenty day period following the repossession. But if the buyer does not redeem within that that period and the seller does not intend to look to the buyer for any deficiency, the seller can resell or otherwise deal with the property as it wishes at any time after the expiration of the period free of the buyer's rights.

The significant disadvantage of the foreclosure remedy is that it extinguishes the mortgage debt whereas with sale the debtor remains liable for any deficiency. True, the secured party also remains liable to account for any surplus after sale whereas foreclosure works a forfeiture of all built up equity in the collateral. However personal property, unlike real estate, is usually subject to depreciation rather than appreciation over time. Thus deficiencies tend to be the norm in the personal property security context.

Since at least the last century, sale has been the almost invariable method of realization on a personal property mortgage. While a mortgagee may still bring action for strict foreclosure in theory, it rarely if ever happens in practice. Similarly, a conditional seller will usually elect to give notice of its intention to resell to the buyer in order to retain a deficiency claim.

'Strict Foreclosure' under the PPSA

The PPSA preserves the 'strict foreclosure' alternative to sale. Under section 61(1), a secured party may propose after default to take the collateral in satisfaction of the secured obligation. But the PPSA version of the remedy is available to all secured parties regardless of the form of the security transaction and regardless of whether or not the secured party has title in the collateral.

A court action is not needed to initiate the foreclosure process under the PPSA. Rather, the secured party simply gives notice of its foreclosure proposal to all those whose interests would be affected by it. In this regard, the classes of persons entitled to notice under section 61(1) are the same ones who are entitled to notice of a proposed disposition of collateral under section 59. Apart from the "debtor" as comprehensively defined in section 1, they include firstly "any other person who is known by the secured party to be an owner of the collateral". The second class comprises subordinate creditors who have registered a financing statement against the debtor or against the collateral by serial number or whose security interest was perfected by possession when the secured party took possession of the collateral This class includes subordinate secured parties *and* unsecured judgment creditors if the latter have registered their interest in the PPSA registry (see section 20). The third class comprises any other person with an interest in the collateral (for instance, a subordinate secured party without a registered financing statement or an unsecured creditor who has delivered an order for seizure and sale to the sheriff) who has given a written notice to the secured party of that interest prior to the date that notice of the foreclosure proposal is given to the debtor.

Under section 61(2), those entitled to notice then have fifteen days to give a notice of objection to the proposal to the secured party. They are entitled to a voice because the foreclosure will effect a forfeiture of any surplus "equity" in the collateral in the relatively rare cases where its value substantially exceeds the secured debt and expenses owed to the foreclosing creditor.

If no objection is made before the expiry of that fifteen day period, the secured party is deemed to have irrevocably elected to take the collateral in satisfaction of the secured obligation. But if notice of objection is received, the secured party will be compelled to forego foreclosure and enforce its security by disposition under section 59.

While even one objection is sufficient to sink a foreclosure proposal, the basis for objection must be a legitimate one. Under section 61(2) notice of objection can be made only if the objector was entitled to notice in the first instance (viz, has an interest in the collateral) and then only if the objector's interest would be adversely affected by the foreclosure. In this respect, section 61(6) entitles the secured party to demand proof of the objector's interest. If proof is not furnished within ten days of demand, the secured party is entitled to proceed as though no objection had been received from that person. Section 61(7) provides a judicial remedy against frivolous and nuisance objections. It entitles a secured party to apply to a court for a ruling that an objection is ineffective on the ground that the objection was motivated by a purpose other than protection of the objector's interest in the collateral or the market value of the collateral is less than the debt owed to the foreclosing creditor plus its enforcement expenses.

SECTION 62

DEBTOR'S RIGHTS OF REDEMPTION AND REINSTATEMENT

62(1) **At any time before the secured party or a receiver has disposed of the collateral or contracted for disposition under section 59 or before the secured party is deemed to have irrevocably elected to retain the collateral under section 61,**

(a) any person entitled to receive a notice of disposition under subsection 59(6) or (9) may, unless that person otherwise agrees in writing after default, redeem the collateral by tendering fulfillment of the obligations secured by the collateral,

(b) the debtor, other than a guarantor or indemnitor, may, unless the debtor has otherwise agreed in writing after default, reinstate the security agreement by paying the sums actually in arrears, exclusive of the operation of an acceleration clause in the security agreement and by curing any other default by reason of which the secured party intends to dispose of the collateral,

together with a sum equal to the reasonable expenses of seizing, repossessing, holding, repairing, processing and preparing the collateral for disposition if such expenses have actually been incurred by the secured party, and any other reasonable expenses incurred by the secured party in enforcing the security agreement.

62(2) **Unless otherwise agreed, the debtor is not entitled to reinstate a security agreement**

(a) more than twice, if the security agreement provides for payment in full by the debtor not later than 12 months after the day value was given by the secured party,

(b) more than twice in each year, if the security agreement provides for payment by the debtor during a period of time in excess of one year after the day value was given by the secured party.

COMMENTARY

Historical Background

The subject of section 62 is the debtor's time-honoured equity of redemption - her right to cure the default and redeem the collateral at any time after default and before the collateral is irrevocably disposed of by sale or foreclosure. Rooted in seventeenth century land law, the concept of redemption was developed by the courts of equity in an era of highly stable and sentimental land tenure and in an economy where being land-rich and cash-poor was a not uncommon condition. An extraordinarily protracted redemption period (six months after which the decree absolute for foreclosure might still be reopened in the court's discretion) served to keep the land in the family and protected against creditors' windfalls.

While a right to redeem is read into every personal property security instrument by analogy to land law, the right is not at the same level of importance. The two most common cases where the debtor will realistically want to redeem is where the value of the collateral exceeds the value of the outstanding loan or where the collateral has unique or sentimental value for the debtor. But unlike real estate, personal property is more likely to depreciate than appreciate over time; this reduces the incidence of cases where the collateral is objectively worth redeeming. And unlike the family estate, secured parties rarely advance vast sums against the debtor's romantic souvenirs, photograph albums and family heirlooms; this reduces the incidence of cases where the collateral is subjectively worth redeeming.

All of this is not to say that a redemption right should be abolished altogether in the personal property security context. There are enough exceptional cases to justify retaining the right especially when one considers that any default as defined in the security agreement (and therefore in most cases as defined by the secured party) is sufficient to trigger the secured party's enforcement rights against the collateral. What the limited use of redemption in this context does auger for is a statutorily defined redemption right and a relatively abbreviated redemption period, from the termination of which there is no going back. The need for a considerably diluted redemption right when it comes to personal property is recognized in existing law. Section 15(1) of the *Conditional Sales Act*, for instance, allows the buyer twenty days following repossession to cure default on the expiry of which the right to redeem also expires.

Redemption under the PPSA - Generally

Section 62(1) does not prescribe an *a priori* redemption period. Rather, the right to redeem survives until the secured party has either irrevocably foreclosed or disposed (or contracted to dispose) of the collateral. Under section 59, a secured party who proposes to dispose of the collateral by sale must give advance notice to the debtor and other defined parties not less than 20 days before the intended disposition. Under section 61, a secured party intending to foreclose must likewise give advance notice to the debtor and others who then have fifteen days to register a notice of objection. These mandatory advance notice provisions thus guarantee the debtor a minimal redemption period that is at least equivalent to that presently prescribed by the *Conditional Sales Act* presently without arbitrarily cutting off the right to redeem before it is necessary to do so.

At common law, the terms of redemption generally required payment of the principal amount secured with interest and the costs of the mortgagee. This is codified in section 62 which makes redemption contingent on fulfillment of the obligations secured by the collateral together with payment of the secured party's reasonable expenses of enforcement.

Waiver of Redemption Right

At common law, the equity of redemption was regarded as so inseparable from the mortgage transaction that the mortgagee could not lawfully require the mortgagor to release her equity as a condition of the original mortgage agreement. Under section 15(7) of the *Conditional Sales Act*, the buyer's statutory right to redeem similarly endures "notwithstanding any agreement to the contrary". Post-default waivers were permitted, however, and this policy has been maintained in the PPSA. Under section 62, the waiver must be a written one and can only be entered into after the default. The PPSA in other words continues to prohibit an advance waiver of redemption rights in the security agreement. Post-default waivers were seen as justified in view of the fact that the redemption right otherwise survives til the 11th hour.

Who is entitled to Redeem?

Apart from the debtor, others with a valuable interest in the collateral may have an equal or even greater interest in redeeming the collateral so as to take control over the enforcement process and the disposition of the collateral. Suppose, for instance, that collateral with a potential market value of $20,000 is repossessed by a secured party with a $5000 security interest therein. A junior secured party holding a $20,000 security interest in the same collateral may well wish to assume control of the enforcement process in order to ensure the highest return possible on a sale or other disposition and wish to redeem for that purpose. Accordingly, the right to redeem accrues not just to the debtor but to all of the third parties to whom notice must be given under section 59: see further the commentary on that section.

When redemption right terminates

The right to redeem endures under section 62 until the secured party has disposed (or contracted to dispose) of the collateral under section 59 or irrevocably foreclosed under section 60. Once disposition has occurred, section 59(7) guarantees good title to any purchaser who acts in good faith pays value and takes possession regardless of whether or not the requirements of the section have been complied with.

Reinstatement of the Security Agreement

Security agreements that provide for payment at fixed intervals commonly contain an acceleration clause under which upon default in the payment of any one installment, the entire outstanding secured obligation becomes due and payable at the secured party's option. Where the secured party invokes acceleration, can the debtor redeem by simply tendering the past-due installment(s) or does redemption require payment of the entire balance? Judicial reaction has been somewhat mixed. Most courts have upheld the secured party's right to contract for payment of the full amount after default as opposed to the actual arrears[1]. But others have been less sympathetic especially in the credit sales context where it is felt that to permit acceleration is repugnant to the theory of redemption[2].

Unlike the Ontario PPSA, the Western Model expressly permits the debtor to "reinstate the security agreement on payment of the amount actually in arrears, exclusive of the operation of any acceleration clause". This policy was carried over to the Western Model from the Saskatchewan PPSA and has been incorporated into the Alberta and British Columbia PPSA's. However, under the British Columbia version, the right of reinstatement is available only where the collateral is consumer goods. In the other versions, the right to reinstate endures for all classes of collateral until it is disposed of except where a receiver has been appointed. Since receiverships are universally used for all major commercial financing arrangements, there seems to be no good reason why commercial debtors should not get the benefit of a right of reinstatement along with their consumer counterparts in those instances where the security agreement involves the same installment credit. The Saskatchewan experience to date does not support the need for a restriction along the British Columbia lines and section 63(1)(b) of the proposed New Brunswick Act follows the larger trend and permits reinstatement for both commercial and consumer security arrangements.

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[1] See, for instance, *BC Independent Undertaker's Ltd. v. Maritime Motor Car Co* [1917] 3 WWR 22, 35 DLR 551 (BCCA)

[2] *Peresluka v. GMAC (1966)* 56 WWR 90, 56 DLR (2d) 717 (Man QB). And note *Delta Acceptance Corp. v. Redman* (1966) 55 DLR (2d) 481 (Ont CA) per Laskin J., as he then was, dissenting.

Unlike the right of redemption, the right of reinstatement is meant exclusively for the benefit and protection of the debtor. Accordingly, section 63(1)(b) expressly restricts the availability of the remedy to the "debtor, other than a guarantor or indemnitor" (who would otherwise be brought within the concept of "debtor" by the definition in section 1).

A statutory right of reinstatement is meant to protect debtors from overreaching creditors in circumstances where they have accumulated substantial equity in the collateral and their default is minor, temporary and aberational. It is a necessary protection in view of the secured party's relative monopoly in defining and determining events of default. But the right of reinstatement is not meant to encourage chronic recalcitrance and tardiness in payment. Section 62 contains two important safeguards against the risk of debtor abuse of the right. Firstly, under section 62(1), the debtor must not only pay the amount in actual arrears but also cure any other default by reason of which the secured party intends to dispose of the collateral and pay the secured party's reasonable expenses of seizing and holding the collateral. Secondly, under section 62(2), the debtor is not entitled to reinstate more than twice annually.

Like the right of redemption, the debtor's right of reinstatement endures until the secured party has disposed (or contracted to dispose) of the collateral or has irrevocably foreclosed unless the debtor executes a post-default written waiver of its right. But unlike redemption, reinstatement is cut off by the appointment of a receiver (see the definition of "secured party" in section 1).

SECTION 63

SUPERVISORY POWERS OF COURT

63(1) **In this section "secured party" includes a receiver.**

63(2) **On application by a debtor, a creditor of a debtor, a secured party, a sheriff or any person with an interest in the collateral, a court may**

- **(a)** **make any order, including a binding declaration of a right and injunctive relief, that is necessary to ensure compliance with this Part or sections 17, 36, 37 and 38,**
- **(b)** **give directions to any person regarding the exercise of rights or the discharge of obligations under this Part or sections 17, 36, 37 and 38,**
- **(c)** **relieve a person from compliance with the requirements of this Part or sections 17, 36, 37 and 38, but only on terms that are just and reasonable for all persons affected,**
- **(d)** **stay enforcement of rights provided in this Part or sections 17, 36, 37 and 38,**
- **(e)** **make any order necessary to ensure protection of the collateral.**

COMMENTARY

During the enforcement process, it may become necessary for the secured party, the debtor or an interested third party to take judicial recourse to enforce compliance, or to seek relief from compliance, with the default enforcement provisions of the act or simply to request directions in the face of unforseen circumstances. Section 63 ensures that the Court has liberal discretionary powers in this regard.

NOTES

SECTION 64

RECEIVERSHIPS

64(1) A security agreement may provide for the appointment of a receiver and, except as provided in this or any other Act, the receiver's rights and duties.

64(2) A receiver shall

(a) take custody and control of the collateral in accordance with the security agreement or order under which the receiver is appointed, but unless appointed a receiver-manager or unless the court orders otherwise, shall not carry on the business of the debtor,

(b) where the debtor is a corporation, immediately notify the Director of Corporations of the appointment or discharge who shall forthwith cause to be published in *The Royal Gazette* notice of such appointment or discharge,

(c) where the debtor is a corporation, forthwith after appointment and from time to time thereafter file with the Director of Corporations a notice designating an office in the Province where the records referred to in (e) shall be maintained,

(d) open and maintain, in the receiver's name as receiver, one or more accounts at a bank, credit union or similar institution for the deposit of all money coming under the receiver's control as receiver,

(e) keep detailed records, in accordance with accepted accounting practices, of all receipts, expenditures and transactions involving collateral or other property of the debtor,

(f) prepare at least once in every 6-month period after the date of the appointment financial statements of the administration and, where the debtor is a corporation, file a copy with the Director of Corporations within sixty days after the end of each six-month period subject to any order of the Court,

(g) indicate on every business letter, invoice, contract or similar document used or executed in connection with the receivership that the receiver is acting as a receiver,

(h) on completion of the receiver's duties, render a final account of the administration and send copies to the debtor and, where the debtor is a corporation, to the directors of the debtor and to the Director of Corporations who shall file it.

64(3) The debtor, and where the debtor is a corporation, a director of the debtor, or the authorized representative of any of them, may, by a demand in writing delivered to the receiver, require the receiver to make available for inspection the records referred to in subsection (2)(e) during regular business hours at the office of the receiver designated in subsection 2(c).

64(4) The debtor, and where the debtor is a corporation, a director of the debtor, sheriff, a person with an interest in the collateral in the custody or control of the receiver, or the authorized representative of any of them, may, by a demand in writing delivered to the receiver, require the receiver to provide copies of the financial statements referred to in subsection (2)(f) or the final accounts referred to in subsection (2)(h) or to make them available for inspection during regular business hours at the office of the receiver designated in subsection 2(c).

64(5) The receiver shall comply with the demand referred to in subsection (3) or (4) not later than 10 days from the date of receipt of the demand.

64(6) The receiver may require the payment in advance of a fee in the amount prescribed for each demand, but the sheriff and the debtor, or in the case of an incorporated debtor, a director of the debtor, are entitled to inspect or to receive a copy of the financial statements and final account without charge.

64(7) Upon application by an interested person, a court may

(a) appoint a receiver,

(b) remove, replace or discharge a receiver, whether appointed by a court or pursuant to a security agreement,

(c) give directions on any matter relating to the duties of a receiver,

(d) approve the accounts and fix the remuneration of a receiver,

(e) notwithstanding anything contained in a security agreement or other document providing for the appointment of a receiver, make an order requiring a receiver or a person by or on behalf of whom the receiver is appointed to make good a default in connection with the receiver's custody, management or disposition of the collateral of the debtor or to relieve the person from any default on such terms as the court thinks fit,

(f) exercise with respect to receivers appointed pursuant to a security agreement the jurisdiction that it has over receivers appointed by the court.

64(8) The powers referred to in subsection (7) and in section 63 are in addition to any other powers a court may exercise in its jurisdiction over receivers.

64(9) Unless a court orders otherwise, a receiver is required to comply with sections 59 and 60 only when the receiver deals with collateral other than in the course of operating the business of a debtor.

COMMENTARY

Application of PPSA Enforcement Regime to Receivers

Commercial security agreements typically make express provision for the appointment of a receiver in the event of default. In the absence of a contractual appointment power, the secured party can apply for a court-appointed receiver.

The popularity of the receivership mechanism for commercial debt enforcement lies in the wide powers enjoyed by receiver-managers, enabling them to realize on the collateral in the most profitable and market-oriented fashion possible in the circumstances and even holding out the hope that the business can still be turned around. To that end, receiver-managers are normally empowered to run the business of the debtor, contract on its behalf, and ultimately dispose of the collateral, ideally as part of a still-going concern.

Beginning with Saskatchewan, the later versions of the PPSA take account of the central role played by receivers in commercial debt enforcement. While none attempt to codify receivership law, they all offer express direction on the extent to which the PPSA default enforcement regime applies to receivers as well as secured parties *strictu senso*.

Under the proposed New Brunswick version of the Western Model PPSA, "secured party" is thus defined to include a receiver in sections 17, 36, 37, 38, 55, 56, 57, 58, 59(1), (2), (5), (14), (17), 60, 64, 66.

However, there is an important qualification on the obligation of a receiver to comply with sections 59 and 60. Section 64(9) makes it clear that the receiver does not have to adhere to the relatively onerous notice and other obligations imposed by these sections when disposing of the collateral in the ordinary course of operating the debtor's business. Compliance is necessary only when the disposition is an extraordinary one as in the case of a sale of the business as a going-concern or a bulk sale of part or all of the business assets. All of the contemporary PPSA's contain a similar qualification since to require compliance for the purpose of ordinary course selling would defeat the purpose of a receiver-managership and benefit nobody.

Restatement of Existing Statutory Receivership Law

At present, the statutory law of receiverships in New Brunswick is primarily to be found in Part VII of the New Brunswick *Business Corporations Act* which is modelled on Part IX of the Canada *Business Corporations Act*[1].

The central role played by receivership law in the commercial security enforcement process merits the incorporation of at least the existing statutory rules in PPSA Part 5. While Saskatchewan was the first PPSA jurisdiction to attempt this, jurisdictions which have adopted the Western Model have followed its example.

Accordingly, section 64 of the proposed New Brunswick PPSA restates the existing *Business Corporations Act* provisions on receivers, with such changes as are necessary to accommodate both corporate and non corporate debtors.

Following British Columbia's example, the relevant provisions of the *Business Corporations Act* will be repealed and the application of section 64 will be extended to a receivership of real property as well as personal property under amending legislation introduced along with the PPSA. Since receiverships frequently involve both real and personal property, it would be awkward to retain duplicitous sources of the applicable law for each type.

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[1] These provisions are supplemented on points of procedure by Rule 41 of the New Brunswick *Rules of Court* and on points of substance by the principles of common law and equity.

NOTES

PART 6
TRANSITIONAL AND MISCELLANEOUS

SECTION 65

SUPPLEMENTARY LAW AND DUTIES OF GOOD FAITH AND COMMERCIAL REASONABLENESS

65(1) **The principles of the common law, equity and the law merchant, except insofar as they are inconsistent with the provisions of this Act, supplement this Act and continue to apply.**

65(2) **All rights, duties, or obligations arising under a security agreement, under this Act or under any other applicable law shall be exercised or discharged in good faith and in a commercially reasonable manner.**

65(3) **A person does not act in bad faith merely because the person acts with knowledge of the interest of some other person.**

COMMENTARY

Supplementary Law

Inspired by Article 9 of the UCC, Canadian PPSA legislation sought to integrate all aspects of personal property financing in a single comprehensive legislative treatment. But even the most contemporary of the PPSA models - which are more than twice the length of the originals - are not codes in the civilian sense of a completely self-contained and self-sufficient source of the law in a field. Nor are they codes even to the more limited extent that Article 9 is. While Article 9 reflects the influence of having a comparative lawyer and realist scholar, Karl LLewellyn, as its chief architect, PPSA legislation is written in the highly technical drafting style traditional to Canadian statutes, especially in the commercial field. Moreover, article 9 was written as part of a comprehensive commercial code project, an approach which allowed for cross-referencing to related commercial law principles within a single legislative framework. PPSA legislation had to be drafted to stand alone and thus could codify the law only in the most limited common law sense of legislating specific rules, concepts, principles and standards for those features of personal property security law that are unique to that domain. The principles of the common law, equity and the law merchant must continue to provide a general backdrop to the operation of these specifics except where obviously displaced and the purpose of section 65(1) is to expressly preserve their continued application.

Duties of Good Faith and Commercially Reasonable Conduct

Section 65(2) imposes a comprehensive standard of good faith and commercial reasonableness in the exercise of all rights, duties, or obligations arising under a security agreement, under the PPSA or under any other applicable law.

The inclusion of a requirement of good faith and commercial reasonableness in PPSA legislation has sometimes been received with more alarm than is warranted. Section 65(2) is simply a restatement of a long-established judicial willingness to test commercial conduct against prevailing commercial standards. And the law of personal property security, drawing in turn from land law tradition, has always been regarded by the courts as a particularly natural forum for the exercise of an equitable discretion to restrain high handed conduct and sharp practice, especially in the default enforcement context.[1]

Good Faith and the Relevance of Notice or Knowledge

In existing law, the concept of *bona fides* or good faith is sometimes understood to mean simply without notice, *i.e.* a *bona fide* purchaser or BFP is shorthand for describing a person who acquires an interest in property without knowledge of the existence of a prior interest in favour of a third party.

Many more rules to protect the title acquired by *bona fides* purchasers are needed in a legal system which lacks a reliable accessible public registry system for the disclosure of nonpossessory interests in property. But in a legal system that provides for adequate publicity, transferees can protect themselves by searching for prior interests and the justification for giving them special protection is much diminished.

Because the PPSA establishes an adequate publicity mechanism, the role of notice or knowledge in relation to priority is much diminished under the Act. To the extent that knowledge is still relevant, this is stated expressly in the particular priority rule. Otherwise, it is intended to be irrelevant. The purpose of section 65(3) is to ensure that the obligation of good faith in section 65(1) is not interpreted to include acting with knowledge of a prior interest in property in relation to the operation of those priority rules in which knowledge is meant to be irrelevant. However, section 65 states only that merely taking with knowledge is not bad faith. Knowledge put to an unsavory or sharp use is quite another thing.

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[1] See further the commentary on sections 58, 59 and 55.

SECTION 66

ACTION FOR DAMAGES FOR NON-COMPLIANCE

66(1) In this section "secured party" includes a receiver.

66(2) If a person fails, without reasonable excuse, to discharge any duties or obligations imposed on the person by this Act, the person to whom the duty or obligation is owed has a right to recover loss or damage that was reasonably foreseeable as liable to result from the failure.

66(3) Where a secured party without reasonable excuse fails to comply with obligations

(a) in section 43(12), 49 or 50, or

(b) in section 17, 18, 59, 60 or 61 and the collateral is consumer goods,

the debtor, or, in a case of non-compliance with section 43(12), 49 or 50, the person named as the debtor in a financing statement or registration, is deemed to have suffered damages not less than the amount prescribed.

66(4) In an action for a deficiency, the debtor may raise as a defence the failure on the part of the secured party to comply with obligations in section 17, 18, 59 or 60, but non-compliance shall limit the right to the deficiency only to the extent that it has affected the debtor's right to protect the debtor's interest in the collateral or has made the accurate determination of the deficiency impracticable.

66(5) Where a secured party fails to comply with obligations in section 17, 18, 59 or 60, the onus is on the secured party to show that the failure

(a) where the collateral is consumer goods, did not affect the debtor's ability to protect the debtor's interest in the collateral by redemption or reinstatement of the security agreement, or otherwise, and

(b) did not make the accurate determination of the deficiency impracticable.

66(6) Except as otherwise provided in this Act, a provision in a security agreement or any other agreement that purports to exclude a duty or onus imposed by this Act or that purports to limit the liability of or the amount of damages recoverable from a person who has failed to discharge a duty or obligation imposed by this Act is void.

COMMENTARY

Liability for Damages

Section 66(2) confirms that a person to whom a duty or obligation is owed under the PPSA has a cause of action against any person, who without reasonable excuse, fails to discharge the duty or perform the obligation. The measure of liability is the ordinary common law standard in civil actions: *i.e.*, the plaintiff is entitled to recover damages for losses that were reasonably foreseeable as being liable to result from the defendant's failure to discharge the duty or perform the obligation.

In some instances, however, it may be difficult for a plaintiff to prove that any real tangible loss flowed from the statutory violation. If the statutory standard is not to be rendered a *brutum fulem*, a minimal measure of deemed damages must be set. This is the purpose of section 66(3) which empowers Cabinet to prescribe damages for a breach of specified sections of the Act, regardless of whether any actual loss can in fact be established.

The statutory violations for which a secured party will be liable to pay deemed damages to the debtor are:

non-compliance with the requirement to give the debtor a copy of the financing statement (section 43(12);

non-compliance with a demand to discharge or amend a registered notice in the land registry office (section 49);

non-compliance with the requirement to discharge a registration relating to consumer goods within 30 days after all obligations under the agreement are performed (section 50)

non-compliance with a demand to discharge or amend a registration in the Personal Property Registry (section 50)

Consumer debtors may often face greater difficulty in proving loss or even bothering with the uncertainty and expense of litigation in light of the small amounts likely to be involved. To encourage secured parties to regard their duties to consumer debtors as seriously as they do those owed to their commercial debtors, section 65(3) provides that where the collateral is consumer goods, a secured party will also be liable to pay deemed damages to the debtor for the following violations:

non-compliance with the duty to take reasonable care of collateral in the secured party's possession (section 17)

non-compliance with a demand by the debtor for current information on the security arrangement (section 18)

non-compliance with the requirements governing the secured party's disposal of the collateral on default (section 59)

non-compliance with the requirements governing accounting for and payment of a surplus after enforcement (section 60)

non-compliance with the requirements governing exercise of the remedy of foreclosure (section 61).

Effect of Non-Compliance on Action for a Deficiency

If a secured party fails to comply with the PPSA statutory standards governing its possession and disposition of the collateral, what effect ought this to have on the right to a deficiency? Clearly, the debtor will be entitled to set-off any actual or prescribed damages for which the secured party is liable under section 65. The more controversial question is whether the secured party's non-compliance should have the more drastic effect of causing an absolute forfeiture of the right to a deficiency.

Under existing New Brunswick law, a conditional vendor cannot recover a deficiency following repossession and resale unless the contract contains an express deficiency clause. Moreover, compliance with the contractual conditions governing repossession and resale is a necessary but not a sufficient condition of recovery. The conditional vendor's deficiency will still be lost unless the vendor adheres strictly to the notice and other requirements set down in the *Conditional Sales Act*[1]. This result rests on the theory that since the conditional seller's automatic right to a deficiency is derived from and regulated by statute rather the common law, compliance with the notice and other formal requirements governing resale is a necessary prerequisite to the success of the deficiency claim.

But in relation to chattel mortgages and other forms of security, the dominant common law position seems to be that creditor noncompliance with notice and other enforcement duties does not *per se* terminate or diminish the deficiency claim[2].

In the PPSA context, it appears that the drafters of UCC Article 9 simply did not think of the problem and the first and second generation PPSA's have likewise left it to the courts to grapple with an appropriate response.

There are, predictably, cogent arguments on both sides of the issue. An absolute bar on the right to claim a deficiency on proof of insufficient notice or other creditor non-compliance would reduce dispute resolution. Moreover, the ratio of formality to flexibility in the Part 5 enforcement code has been kept deliberately low so as to ensure that the secured party is able to respond to particular market conditions and achieve the best price possible on the sale while still protecting the debtor's right to notice and an informed response. Why then, it is asked, should a secured party who has breached this minimalist code still be entitled to claim a deficiency from the debtor?

In favour of limiting the effect of non-compliance to a set-off of real loss, it is argued that a debtor should not escape her debt obligations because of some technical failure to observe the formal procedures for realization without at least having to establish that the non compliance caused actual prejudice as where, for instance, it prevented her from exercising her right of redemption or resulted in a lower price than would otherwise have been obtainable. The argument on this side is significantly strengthened by the secured party's liability to pay both actual and deemed damages for breach of the notice duties under Part 5, a right which does not exist in the pre-PPSA conditional sales law.

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[1] *Conditional Sales Act*, section 15; *LaBelle v. Traders Finance* (1957) 9 DLR (2d) 275 (NBCA); *C.A.C. v. Fisher* [1958] SCR 546, *Delta Acceptance Corp. v. Redman* (1966) 55 DLR (2d) 481 (Ont CA); *Canadian Acceptance Corporation Ltd. v. Melanson* (1976) 15 NBR (2d) 129, 69 DLR (3d) 695 (NBCA)

[2] The Ontario Court of Appeal has taken the position that "at common law it was only in the case of a conditional sale contract that the creditor, in the absence of an agreement to the contrary, was not entitled to recover the deficiency upon the repossession and resale of the property sold": *Bank of Montreal v. Featherstone* (1989) 9 PPSAC 139 at 143 *per curiam*. That the remedy in the case of a chattel mortgage is one of set-off rather than a total loss of deficiency rights is reflected in section 47(2) of the New Brunswick *Property Act* which states that the title of a purchaser at the secured party's sale is not impeachable because of a failure to give notice or an otherwise improper or irregular exercise by the secured party of its power of sale "but any person damnified by an unauthorized or improper or irregular exercise of the power shall have his remedy in damages against the person exercising the power".

The old Ontario PPSA failed to clarify whether the secured party had an automatic statutory right to claim a deficiency or whether it had to rely on either the security agreement or the common law for one. This accidental omission left room for the incorporation of the pre-PPSA conditional sales jurisprudence into the PPSA context in Ontario. The result under the old Act was that a conditional vendor who failed to give notice was deprived of the right to claim a deficiency in the absence of an express covenant allowing the claim.

Happily, the drafters of the Western Model PPSA chose to provide statutory guidance on the question, adopting a "middle ground" solution as the only fair means of resolving the competing arguments and because it represents the current climate of judicial opinion on the issue [3].

Under section 66(4), proof of a statutory violation will limit the right to a deficiency only if it affected the defendant's right to protect her interest in the collateral or made the accurate determination of the deficiency impracticable. But under section 66(5), it is the secured party and not the debtor who has the burden of establishing that the non-compliance did not affect the accurate determination of the price. The result is to free the debtor from any liability for a deficiency unless the secured party is able to positively prove that the price was not affected by the noncompliance.

Placing the burden of proof on the secured party in relation to whether non compliance affected the determination of the deficiency is fair enough since the secured party is the one in control of the relevant evidence regarding the sale and the impugned procedures. But where the issue is whether non-compliance affected the debtor's ability to protect her interest in the collateral by redemption or reinstatement or otherwise, the matter is quite different. Here it is the debtor's subjective economic and other circumstances at the relevant time and the precise nature of the noncompliance which matter. Accordingly, section 66(5) shifts the burden of proof to the secured party on this issue only where the collateral constitutes consumer goods. An exception for consumer debtors is justified because of their greater vulnerability to creditor misbehavior.

The adoption of statutory guidance on the relationship between noncompliance and the right to a deficiency does not eliminate the judicial role. While it gives the courts some general direction on the relevant questions to ask, it still leaves them with the task of developing rules regarding the kind and quantity of evidence needed to rebut the presumption that the secured party's noncompliance eliminates the right to a deficiency.

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[3] For a comprehensive judicial analysis of the problem and the "middle ground" solution, see *Hall v. Owen County State Bank* 23 UCC Rep 267 (1977) (Ind CA), reproduced in part in Bridge & Buckley, *Sales and Sales Financing in Canada: Cases and Materials* (Carswell, Toronto, 1981) at p. 617.

SECTION 67

APPLICATIONS FOR DETERMINATION OF PRIORITIES OR ENTITLEMENT TO COLLATERAL

67 On application of an interested person, a court may

(a) make an order determining questions of priority or entitlement to collateral, or

(b) direct an action to be brought or an issue to be tried.

COMMENTARY

Disputes regarding priority and entitlement to collateral rarely turn on the facts but on the law. Where this is the case, there is no need for a full-blown trial since the facts can normally be established by affidavit evidence or agreement. Section 67 confirms the right of "an interested person" to proceed by way of Notice of Application on either sort of question[1]. On the hearing of the application, the court may either make the order(s) sought or, in the event of complications, direct an action to be brought or an issue to be tried.[2]

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[1] For the procedure on Applications, see Rule 38 of the New Brunswick *Rules of Court*.

[2] Regarding the disposition of an application, see in particular Rule 38(09) of the New Brunswick *Rules of Court*.

NOTES

SECTION 68

APPLICATIONS FOR EXTENSION OF TIME

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68 **Where in Part 5 or in section 11, 36(14), 38(13) and 43(14) a time is prescribed not later than or before which an act of thing must be done, a court, on application made before or after the time has expired, may extend or abridge, conditionally or otherwise, the time for compliance.**

COMMENTARY

Various sections of the PPSA stipulate precise time periods for doing some act.

Where a time period constitutes a grace period for perfection or a period of temporary perfection period, it would be wrong-headed to then allow a judicial discretion to extend or abridge it. The availability of any such discretion would upset the entire system of priorities established by the Act.

But in other cases, the time period involved relates simply to the giving of notice, the delivery of information, or the initiation of some procedure. This is true of the time periods relating to enforcement under Part 5 and in relation to the time periods prescribed by section 11 (giving debtor copy of the security agreement), section 36 (notice re removal of fixtures), section 38 (notice re removal of accessions) and section 43 (giving debtor copy of the financing statement). In these instances, there is nothing to justify an inflexible approach to the relevant time period if good reason can be shown for an abridgement or extension and no prejudice will result. Accordingly, section 68 authorizes a court to extend or abridge the time for compliance under any of these provisions either before or after the time has expired.

NOTES

SECTION 69

SERVICE OF NOTICES

69(1) A notice or a demand under this Act, other than a demand under section 18 or a copy of a financing statement or a verification statement referred to in section 43(12), may be given to

(a) an individual, by leaving it with the individual or by sending it by registered mail addressed to

(i) the individual by name at the individual's residence, and

(ii) where the individual is the sole proprietor of a business, the name of the individual at the address of the business,

(b) a partnership

(i) by leaving it with

(A) any one or more of the general partners, or

(B) any person at a place of business of the partnership who appears, at the time the notice or demand is given, to be in control or management of the partnership business, or

(ii) by registered mail addressed to

(A) the partnership,

(B) any one or more of the general partners, or

(C) any person who appears, at the time the notice or demand is given, to be in control or management of the partnership business,

at the address of a partnership business,

(c) a corporation, other than a municipality,

(i) by leaving it with an officer or director or agent of the corporation or with the manager or a person who appears to be in control or management of any office or other place where the coporation carries on business,

(ii) by leaving it with or by sending it by registered mail addressed to the corporation at its head office or at any address given in the last state-

ment delivered to the Minister of Justice,

(d) a municipality by leaving it with, or sending it by registered mail addressed to, the principal office of the municipality or to the mayor, deputy-mayor, clerk, assistant clerk, or with any solicitor for the municipality,

(e) an unincorporated association

(i) by leaving it with an officer of the association, or with any person at any office or premises occupied by the association who appears to be in control or management,

(ii) by sending it by registered mail addressed to an officer of the association at the address of the officer, and

(f) on the Crown in Right of the Province in the manner provided in the *Proceedings against the Crown Act*.

69(2) A notice or demand sent by registered mail is deemed to be given on the earlier of

(a) the date the addressee actually receives the notice or demand, or

(b) except when postal services are not functioning, the expiry of 10 days after the date of registration.

COMMENTARY

Section 69 stipulates the procedure for serving a notice or demand under the PPSA. These will include:

Section 34	Notice of purchase money security interest in inventory to prior registered secured party
Section 36	Notice of intention to remove goods from land
Section 37	Notice of intention to remove crops from land
Section 37	Notice of intention to remove an accession
Section 39	Notice of purchase money security interest to secured party with a registered interest in the product or mass
Section 41	Notice of assignment to account debtor
Section 49	Demand for discharge or amendment of notice of security interest in a fixture or growing crop
Section 50	Demand for discharge or amendment of financing statement

Section 57	Notice to debtor on an intangible, chattel paper or instrument to make payment
Section 59	Notice of disposition of collateral
Section 60	Notice of interest in collateral prior to distribution of surplus
Section 61	Notice of proposal to take collateral in satisfaction of the debt
Section 61	Notice of objection to proposal to take collateral in satisfaction of the debt
Section 64	Demand for inspection of records of receiver

Demands under section 18 and the sending of a copy of a financing statement or verification statement to the debtor under section 43(12) are excepted from the general section 69 procedure. These sections provide independent rules.

In addition, a number of the above sections contain supplementary methods of delivery which may be used as alternatives to the section 69 procedure: see sections 34, 36, 38, 49, 50, 59 and 61.

To avoid confusion, the delivery rules set out in section 69 have been drafted to conform fairly closely to the service rules found in Rule 18 of the New Brunswick *Rules of Court*.

NOTES

SECTION 70

CONFLICTS BETWEEN PPSA AND OTHER LEGISLATION

70(1) **If there is a conflict between a provision of this Act and a provision for the protection of consumers in any other Act, the provision of that Act prevails.**

70(2) **Except as otherwise provided in this or any other Act, where there is a conflict between a provision of the Act and a provision of any other Act other than an Act referred to in subsection (1), the provision of this Act prevails.**

COMMENTARY

Section 70 offers guidance on the order of priority between the PPSA and other New Brunswick statutes in the event of inconsistency.

Section 70(2) states the general rule: the PPSA prevails except as expressly otherwise provided in the PPSA itself or in another Act. There is no room, in other words, for a finding of tacit repeal of any provision of the PPSA by virtue of its repugnancy with provision of another act.

Section 70(1) states an important exception to the general rule. Where a conflict arises between a provision of the PPSA and a provision in any other statute that relates to consumer protection, the policy favouring consumer protection is to prevail. This exception is derived from the Western Model in recognition of the prevalence of consumer protection legislation in western jurisdictions. In view of the relative dearth of consumer protection legislation in New Brunswick, the circumstances in which it will be necessary for to invoke section 70 are apt to be rare. However, there is perhaps some potential for conflict between the PPSA and such statutes as the *Cost of Credit Disclosure Act* and the *Consumer Product Warranty and Liability Act* and section 70 will provide guidance if and when more extensive consumer protection legislation is introduced in this field.

NOTES

SECTION 71

TRANSITIONAL - REFERENCES TO PREVIOUS LEGISLATION AND TERMINOLOGY

71(1) **A reference in any Act, regulation, agreement or other writing to the *Assignment of Book Debts Act*, the *Bills of Sale Act*, the *Conditional Sales Act*, or the *Corporation Securities Registration Act* that relates to a security interest is deemed to be a reference to this Act or to the corresponding provisions of this Act.**

71(2) **A reference in any Act, regulation, agreement or other writing to a chattel mortgage, conditional sales contract, fixed charge, floating charge, pledge or assignment of book debts or the like, or any derivative of these terms or other similar agreement, is deemed to be a reference to the corresponding kind of security agreement under this Act.**

COMMENTARY

The PPSA introduces terminological and conceptual changes to the law of personal property security. On its enactment, the existing registration statutes will be repealed and references to these statutes contained in other statutes will be amended and replaced with a reference to the PPSA. In addition, statutory references to chattel mortgages, conditional sales, and other conventional forms of security will be deleted and replaced with the appropriate PPSA concept.

Section 71 offers interpretative guidance in the event that stautory references to the prior law and prior concepts inadvertently escape amendment. Guidance in translating the old to the new will also be necessary in interpreting pre-PPSA security agreements whose registered status is maintained for a transition period under section 73 as well as in interpreting post-PPSA security agreements which are drafted in conventional terms.

Under section 71(1), a reference in any Act, regulation, agreement or document to any of the existing registration statutes is deemed to be a reference to the PPSA while under section 71(2), a reference to a prior form of security agreement is deemed to be a reference to its functional counterpart in the PPSA conceptual universe.

NOTES

SECTION 72

TRANSITIONAL APPLICATION OF ACT

72(1) In this section and section 73,

(a) "prior law means the law in force immediately before [the date this Act comes into force],

(b) "prior security interest" means an interest created, reserved or provided for by a valid security agreement or other transaction made before this ACt comes into force that is a security interest within the meaning of this Act and to which this Act would have applied if it had been in force at the time the security agreement or other transaction was entered into.

72(2) This Act applies

(a) to every security agreement made after [the date this Act comes into force], including an agreement that renews, extends, or consolidates an agreement that renews, extends or consolidates an agreement made before [this Act comes into force]

(b) to a receiver appointed before or after [the date this Act comes into force]

(c) to every security agreement made before [the date this Act comes into force] that has not been validly terminated in accordance with the prior law before [the date this Act comes into force]

(d) subject to subsections (3) and (4), to every prior security interest that is not enforced or otherwise validly terminated in accordance with the prior law before [the date this Act comes into force]

72(3) Sections 10 and 11 do not apply to a security agreement referred to in subsection 2(b).

72(4) The validity of a prior security interest is governed by the prior law.

72(5) The order of priorities

(a) between prior security interests is determined by prior law, if all the competing security interests arose under security agreements entered into before [the date this Act comes into force] and

(b) between a prior security interest and the interest of a third party is determined by the prior law, if the third party interest arose before [the date this Act comes into force] and the security interest arose under a security agreement entered into before [the date this Act comes into force].

COMMENTARY

Section 73 makes it clear that the PPSA applies not just to security agreements entered into after the Act comes into force but to all existing security agreements as well. This means, for instance, that the enforcement of a chattel mortgage entered into under the pre-PPSA law will be governed by PPSA Part 5 if the enforcement process does not conclude before the Act comes into force.

To this general rule, section 73 inevitably creates several necessary exceptions.

Firstly, security agreements entered into under the prior law are not subject to the section 10 and 11 evidentiary requirements of the PPSA.

More generally, the validity of a security agreement entered into under the prior law is governed by the prior law.

Finally, priority contests that involve only pre-PPSA interests are governed by the prior law.

See further section 73 regarding the transitional perfection of pre-PPSA security interests.

SECTION 73

TRANSITIONAL PERFECTION OF PRIOR SECURITY INTERESTS

73(1) **In this section, "prior registration law" means the *Assignment of Book Debts Act*, the *Bills of Sale Act*, the *Conditional Sales Act*, the *Corporation Securities Registration Act* and the *Forest Products Loan Act* as they existed immediately before the coming into force of this Act.**

73(2) **Except as otherwise provided in this section, a prior security interest that on [the date this Act comes into force] is covered by an unexpired filing or registration under prior registration law is deemed to have been registered and perfected under this Act and, subject to this Act, the registered and perfected status of such interest continues for the unexpired portion of the filing or registration, as the case may be, and may be further continued by registration under this Act if the security interest could have been perfected by registration if it had attached after [the date this Act comes into force].**

73(3) **A prior security interest registered under the *Corporation Securities Registration Act* is deemed to have been registered and perfected under this Act, and that perfection continues until [three years after the date this Act comes into force] but may be further continued under this Act by registration under this Act if the security interest could have been perfected by registration if it had attached after [the date this Act comes into force].**

73(4) **A prior security interest that under prior law had the status of a perfected security interest without filing or registration and without the secured party taking possession of the collateral, is perfected under this Act as of the date the security interest was created, and that perfection continues until [three years after the date this Act comes into force], after which it becomes unperfected unless, being a security interest that could have been perfected under this Act if it had arisen after this Act comes into force, it is otherwise perfected under this Act.**

73(5) **For the purposes of subsection (4), a security interest was perfected under prior law when the secured party has complied with the prior law with respect to the creation and continuance of the security interest and the security interest has the status in relation to the interest of other secured parties, buyers, judgment creditors or the trustee in bankruptcy of the debtor, similar to that of an equivalent security interest created and perfected under this Act.**

73(6) **A prior security interest in the form of an assignment of an existing or future debt to which *The Assignment of Book Debts Act* did not apply**

(a) is deemed perfected for the purposes of section 20(1)(a) and (b), and

(b) is perfected under this Act for all other purposes as of the date notice of the assignment is given to the account debtor,

and that perfection continues until [three years after the date this Act comes into force],

after which it becomes unperfected unless it is otherwise perfected under this Act.

73(7) A prior security interest that on [the date this Act comes into force] could have been, but was not

(a) filed or registered under prior registration law, or

(b) perfected under prior law through possession of the collateral by the secured party,

may, if it is a security interest that could have been perfected by registration or possession under this Act if it had arisen after [the date this Act comes into force], be perfected by registration or possession in accordance with this Act.

73(8) A prior security interest that under this Act may be perfected by the secured party taking possession of the collateral is perfected for the purposes of this Act when possession of the collateral is taken in accordance with section 24 whether the possession was taken before or after [the date this Act comes into force] and notwithstanding that under prior law the security interest could not be perfected by taking possession of the collateral.

73(9) A prior security interest that, on [the date this Act comes into force], was covered by an unexpired filing or registration under prior registration law and that is perfected under this Act without registration or the secured party taking possession of the collateral, remains perfected under this Act.

73(10) A prior security interest that, on [the date this Act comes into force], could have been, but was not, covered by a filing or registration under prior registration law and that, under this Act, may be perfected without registration or the secured party taking possession of the collateral, is perfected under this Act if all of the conditions for perfection of a security interest are met.

73(11) Where the perfection of a prior security interest that is deemed registered or perfected under this section is continued by registration under this Act,

(a) registration under this Act continues any registration or perfected status under prior law for the purposes of section 72(5), and

(b) the registration supersedes any registration or perfection under prior law.

COMMENTARY

Purpose

Section 73 provides transitional rules for determining whether, when and for how long a pre-PPSA security interest is to be regarded as perfected upon the coming into force of the Act.

In Saskatchewan and Manitoba, all unexpired pre-PPSA registrations were converted in a limited format to the PPSA registry system. But in British Columbia and Alberta, a complete conversion was not considered feasible. The volume of prior registrations was higher and not all of the prior registrations had been automated.

In New Brunswick, none of the existing registry systems are automated and even a partial transfer of the existing registry records is not likely to be feasible. Section 73, which is derived from the British Columbia and Alberta PPSA's, has therefore been drafted on the assumption that no automatic transition will take place.

Summarily stated, section 73 continues the perfected status of all pre-PPSA security interests which are regarded as validly registered or otherwise perfected under prior law when the Act comes into force. As a general rule, perfection will be maintained for a three year period or until any pre-PPSA registration expires, whichever is earlier. It follows that during this three-year transition period, credit searchers will have to check both the old registries and the Personal Property Registry.

Continued Perfection of Unexpired *Assignment of Book Debts Act*, *Conditional Sales Act* or *Bills of Sale Act* Registrations

The *Conditional Sales Act*, the *Bills of Sale Act* and the *Assignment of Book Debts Act* all limit the registration life of a registered instrument to 3 years, with the right to renew for further 3-year periods. Sections 73(2) and (9) address the perfected status of security interests subject to an unexpired registration under any of these Acts upon the coming into force of the PPSA.

If the interest is one that could have been perfected by registration if it had attached after the PPSA came into force, section 73(2) deems it to be registered and perfected for the balance of its three-year registration life. To further maintain continuity of perfection, the secured party must re-register in the Personal Property Registry before the expiry of that period.

Section 73(9) addresses the relatively rare case where the unexpired filing relates to a security interest that is treated as perfected under the PPSA without registration or the secured party taking possession of the collateral. Security interests in this category simply remain perfected so long as the conditions for perfection under the PPSA continue to be met.

Continued Perfection of Undischarged *Corporation Securities Registration Act* Registrations

Security agreements registered under the *Corporation Securities Registration Act* remain registered unless positively discharged. Under section 73(2), all *CSRA* registrations which have not been discharged when the PPSA comes into force will be deemed to be registered and perfected for a three year period. Their perfected status may be further continued by re-registering in the Personal Property Registry before the three year period expires.

In the event the unexpired *CSRA* registration relates to a security interest that is treated as perfected under the PPSA without registration or the secured party taking possession of the collateral, it will simply remain perfected pursuant to section 73(9) so long as the conditions for perfection under the PPSA continue to be met.

Continued Perfection of Prior Security Interests not Required to be Registered under Pre-PPSA Law

Many security interests which will become subject to the perfection requirements of the PPSA when it comes into force enjoy perfected status under the existing law without either registration or the secured party taking possession of the collateral. This includes true leases for a term of more than one year (unless they contain an option to purchase), commercial consignments and most security interests taken in collateral other than goods or book debts.

Under section 73(4), security interests falling into this category are deemed to be perfected for PPSA purposes as of the date they were created and their perfected status will be grandmothered for a three year period following the coming into force of the Act. Perfection may be further continued by re-registering in the Personal Property Registry before the three year period expires.

Because "perfection" is a legal term of art under the PPSA, guidance is needed on what constitutes its equivalent under prior law in order to apply section 73(4). Under section 73(5), a security interest will be regarded as perfected under prior law "when the secured party has complied with the prior law with respect to the creation and continuance of the security interest and the security interest has the status in relation to the interest of other secured parties, buyers, judgment creditors or the trustee in bankruptcy of the debtor, similar to that of an equivalent security interest created and perfected under this Act".

Continued Perfection of Specific Assignments of Book Debts not subject to the *Assignment of Book Debts Act*

Section 73(5) states a special transitional rule where the prior security interest takes the form of an assignment of an existing or future debt to which the *Assignment of Book Debts Act* does not apply[1].

Under existing law, an assignee of a book debt must give notice of the assignment to the third party account debtor in order to perfect its security interest as against other assignees of the same debt. This is the so-called rule in *Dearle v. Hall* under which priority as between subsequent assignees of the same debt is determined by the order in which notice is given to the account debtors unless the first-notifying assignee knew about an earlier assignment when it took its own.

Section 73(5) effectively grandmothers the perfection rule in *Dearle v. Hall*. Prior security interests in the form of an assignment of an existing or future debt to which *The Assignment of Book Debts Act* did not apply are deemed perfected for a three year period only *after* notice of the assignment is given to the account debtor.

The rule in *Dearle v. Hall* is restricted to a contest between successive purchasers or mortgagees of the same debt. As between an assignee and a judgment creditor of the assignor, the creditor cannot gain priority simply by serving its garnishing order on the account debtor before the assignee gives notice of the assignment. Section 73(6) maintains the prior law in this respect. As against the interests referred to in section 20(1)(a) and (b) - i.e., the debtor's execution creditors and trustee in bankruptcy - the specific assignment is deemed to be continuously perfected for a three year period without notice.

In all cases, the prior interest must be re-registered in the Personal Property Registry before the expiry of the applicable period of deemed registration or its perfected status will lapse.

The rule in *Dearle v. Hall* also applies to general assignments of accounts which are at present registered under the ABDA. Such interests will be deemed perfected on the coming into force of the Act pursuant to section 73(2) even where notice is not given to the account debtor. However, this does not mean that the rule in *Dearle v. Hall* may not be applicable. Under section 72(5), priority status among competing pre-PPSA interests is generally determined by prior law.

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[1] Section 2(b) and (c)

Continued Perfection of Pre-PPSA Security Interests that should have been but were not Registered under Prior Law

Sections 73(7) and (10) address the perfected status of pre-PPSA security interests that, when the PPSA comes into force, could have been, but are not, perfected by registration or taking possession under the prior law.

Section 73(7) applies if the security interest is one that could have been perfected under the PPSA if it had arisen after the Act came into force. Section 73(7) makes it clear that such interests are to be perfected by registration or taking possession in accordance with the PPSA rather than the prior law notwithstanding that they arose before the Act came into force.

Section 73(10) applies in the relatively rare event that the unregistered pre-PPSA security interest is one that could have been registered under the prior law but is treated as perfected under the PPSA without registration or taking possession. Such interests will simply be treated as perfected on the coming into force of the PPSA notwithstanding failure to register under the prior registration law.

Continued Perfection of Pre-PPSA Possessory Security Interests

Under PPSA section 24, taking possession perfects a security interest in goods, negotiable documents of title to goods, instruments, securities and money. Existing law likewise regards taking possession of the collateral as sufficient to create an effective pledge of goods, documents of title and instruments. But whether the scope of the common law pledge extends to the other categories of collateral listed in section 24 is not clear. Chattel paper, in particular, might prove problematic since its status as a distinct category of personal property is novel to the PPSA. For this reason, section 73(8) makes it clear that taking possession of the collateral in accordance with section 24 will perfect a pre-PPSA security interest even if possession is taken before the date the Act comes into force and notwithstanding that the security interest is one that could not have been perfected under the prior law by taking possession.

Effect of Reperfecting under the PPSA

Under section 72, the validity of pre-PPSA security interests and their priority as against other pre-PPSA security interests will continue to be governed by the prior law even after the PPSA comes into force. Section 73(11)(a) is intended to make it clear that this holds true even where the pre-PPSA security interest is re-registered under the PPSA in order to maintain continuity of perfection beyond the applicable transitional period. However, under paragraph (b), registration under the PPSA will supersede any registration or perfection under the prior law. This ensures that a secured party who re-registers under the PPSA cannot go back and rely on an unexpired pre-PPSA registration should the PPSA registration expire, be discharged or turn out to be defective.

NOTES

SECTION 74

REGULATIONS

74(1) The Lieutenant Governor in Council may make regulations

(a) prescribing the kinds of goods the leases of which are not within the scope of the Act,

(b) prescribing the duties of the Registrar,

(c) respecting the location and hours for the offices of the Registrar or any of them,

(d) respecting the Registry, including the transition from any prior registry system to the system established by this Act,

(e) respecting the payment of fees and prescribing their amount and the manner of payment of them,

(f) prescribing the time, place and all other matters relating to the registration of documents that may or are required to be registered under this Act,

(g) prescribing the form, content and manner of use of financing statements and financing change statements to be used to register security interests under this Act,

(h) prescribing the form, content and manner of use of notices referred to in this Act, including notices required to be registered under section 49 in a land registry or land titles office,

(i) prescribing the manner in which collateral, including proceeds collateral, is to be described in financing statements and prescribing what kinds of goods may be described in part by serial number and what kinds of goods must be described in part by serial number and the requirements of a description by serial number,

(j) prescribing the time, place and all other matters pertaining to searches of the Registry and the method of disclosure of registered information, including the form of search result;

(k) requiring or permitting the use of statements to confirm the registration of information on financing statements and financing change statements,

(l) permitting the Registrar to amend a registration that contains an error caused by the act of the Registrar or Registry employees and prescribing the limits of the amendments;

(m) prescribing abbreviations, expansions or symbols that may be used in a financing

statement or other form, notice or document used in connection with the registration of security interests or the disclosure of information in the Registry,

(n) prescribing the length of time during which a registration is to be effective and the manner in which the period of time is to be indicated,

(o) prescribing the maximum amounts of compensation payable or recoverable under section 52 to 54,

(p) defining any word or expression used in this Act that is required to be defined for the purposes of the regulations,

(q) authorizing the Registrar to make arrangements providing for the deferred payment of fees and charges and prescribing conditions that must be met if the arrangements are to be made available or continue to be made available to particular persons,

(r) prescribing the amount of the charge to which a secured party or person named as a secured party in a financing statement is entitled under section 18 and 64,

(s) prescribing the amount of damages payable by a secured party under section 65

(t) prescribing any matter required or authorized by this Act to be prescribed.

COMMENTARY

All versions of the PPSA authorize the Lieutenant Governor in Council to make regulations prescribing fee schedules, registration logistics and documents and other matters of detail relating to the day to day administration of the Act and the functioning of the Personal Property Registry. The New Brunswick PPSA Regulations will be finalized once final decisions are reached on the nature of the computer infrastructure that will support the registry system.